No. 21207

United States Court of Appeals
For the Ninth Circuit

LARRY P. SMITH, et al., *Appellants,*
vs.
HILLTOP REALTY, INC., et al., *Appellees,*

HILLTOP REALTY, INC., et al., *Cross-Appellants,*
vs.
LARRY P. SMITH, et al., *Cross-Appellees,*
and
THE AUSTIN COMPANY,
Additional Cross-Appellee as to Count No. 4 only.

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT OF THE WESTERN DISTRICT OF WASHINGTON

OPENING BRIEF OF LARRY P. SMITH, ET AL., AS APPELLANTS

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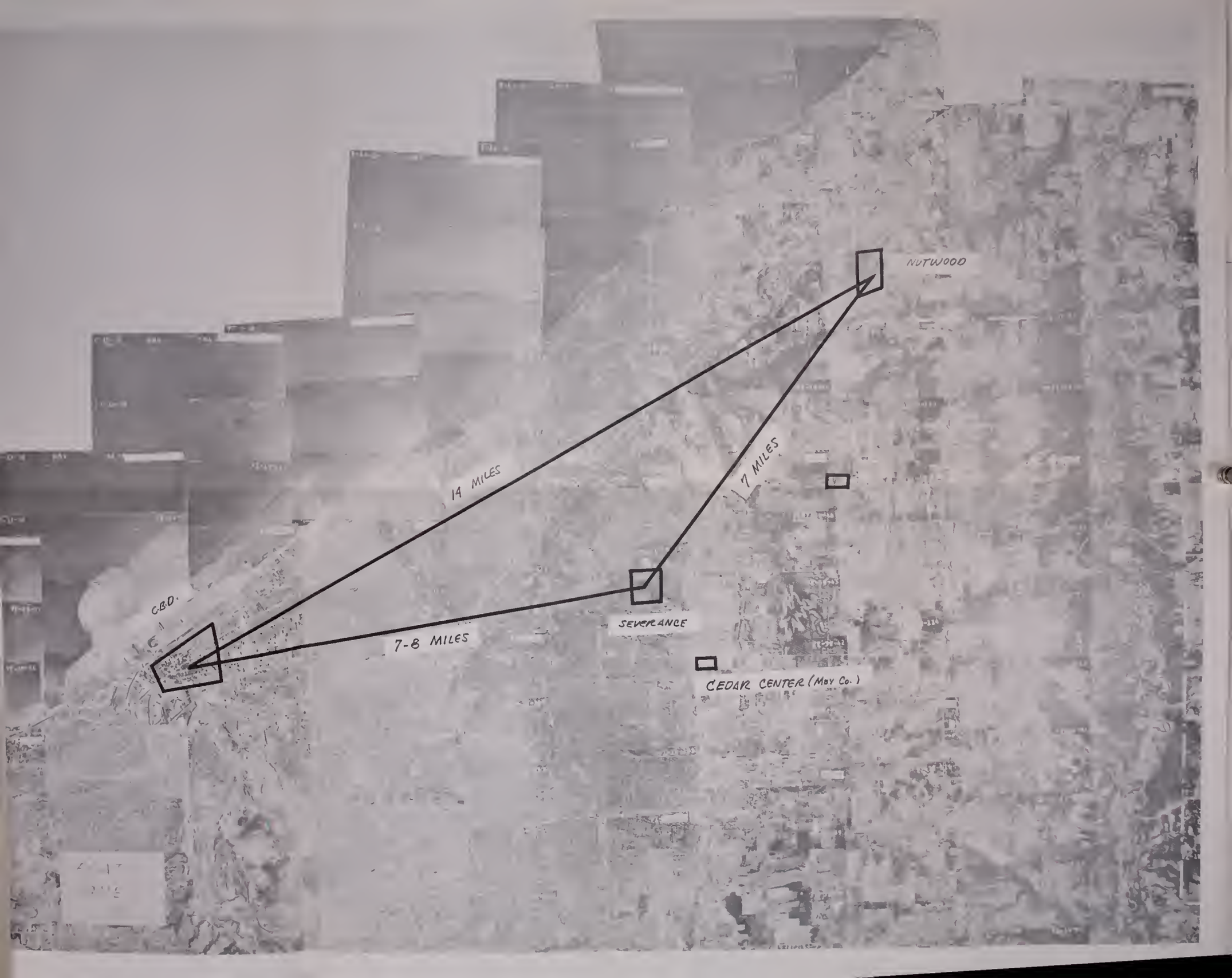
NUTWOOD
14 MILES
7 MILES
C.B.D.
7-8 MILES
SEVERANCE
CEDAR CENTER (Mon Co.)

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OPENING BRIEF OF LARRY P. SMITH, ET AL., AS APPELLANTS

INTRODUCTORY NOTE

The facts relevant to this appeal are few and almost entirely undisputed. Since the record is lengthly (2,234 pages of pleadings, 2,792 pages of reporter's transcript and 372 exhibits), we have filed with this brief an appendix which includes written memorandum decisions and oral opinions of the trial judge (App. 1-26), highlights in chronological sequence from the admitted facts section of the 370-page pretrial order (App. 26-88), ex-

cerpts from the testimony (App. 88-147), the full text of a key exhibit (App. 149-172), a table summarizing the evidence on one issue (App. 173-176), and a list of exhibits (App. 177-184). To identify sources, appendix references to memorandum decisions are designated (M.D., App. .....), to oral opinions (O.O., App. .....), to the admitted facts (A.F., App. .....), to the record (R., App. .....) and to the testimony (Tr., App. .....). Where not clear from the context, the names of the witnesses are given, e.g., (Jones Tr., App. ... ...).

JURISDICTIONAL STATEMENT

Jurisdiction of the District Court was invoked under 15 U.S.C. § 15 as to the antitrust claim of the first amended complaint (Count 4) and under 28 U.S.C. § 1332 as to the remaining claims, by virtue of diversity and amount. This court has jurisdiction under 28 U.S.C. § 1291.

STATEMENT OF THE CASE

1. Nature of the Case and of this Appeal

This action is by a real estate broker, Hilltop Realty, Inc., and its clients, Mesdames Powell and Asheraft (often referred to herein as the sisters), against members of a real estate consulting firm, Larry Smith & Company, which furnished a report on the market potential for shopping center purposes of Nutwood Farms, a farm owned by the sisters and located in the eastern suburbs

of Cleveland. The conclusions of the report furnished by Smith in January, 1960 pursuant to its agreement with Hilltop indicated Smith's opinion that insufficient retail sales potential existed to justify major shopping center development. No retail development had been undertaken at Nutwood as of the date of trial, five years after the report was submitted. Hilltop, later joined by the sisters, filed an action, asserting four theories of recovery: (1) fraud, based on the fact that the consulting firm had not disclosed a potential proprietary interest in another property (Severance) seven miles southwest of Nutwood, (2) breach of contract, based on the assertion that the report was incorrect and negligently prepared, (3) violation of the Ohio antitrust laws by trying to prevent the development of a shopping center at Nutwood and (4) violation of the Sherman Act, through restraint of a development at Nutwood.

The locations of Nutwood, Severance, the May Company's Cedar Center and the Central Business District (CBD) of Cleveland are shown on an aerial photograph (Ex. 346), Plate 1 hereto.

The district judge dismissed claims (2), (3) and (4) and found in plaintiffs' favor on claim (1). Hence, the claim of fraud is the only one relevant to this appeal. One question presented here would, if resolved in our favor, make the other issues we raise academic. That is, whether the district judge's awards of compensatory

damages ($5,840), punitive damages ($75,000) and attorneys' fees ($75,000) are consistent with other findings by the court that:

(1) plaintiffs' charges that the conclusions of the report were wrong and that Nutwood was worth more than the sisters sold it for were unfounded, (O. O., App. 5-6, M.D. App. 10) and

(2) defendants' motive in failing to disclose that they might buy an interest in Severance was not to overreach plaintiffs but to protect a confidence growing out of a pre-existing consulting relationship, which relationship was discussed fully with plaintiffs when Smith was retained by Hilltop (O. O., App. 2, 8-9, 15, M.D., App. 13).

In short, the threshhold question is, can the trial court's finding of actual fraud stand when the court has found that the plaintiffs failed to prove the incorrectness of the report or that they suffered any damage in selling Nutwood. The trial court's rationale was that the report, while unassailable as to the conclusions expressed, was *legally* worthless because of failure to disclose. Hence, the court found that Hilltop and the sisters were each damaged in the amount paid ($2,920) by Hilltop to Smith for the report. To that finding of compensatory damage, the court added punitive damages and attorneys' fees totalling $150,000, on the theory that defendants' failure to disclose justified plaintiffs in bringing this lawsuit.

The basic question is answered concisely in Ohio Jurisprudence, "Neither fraud without damage nor dam-

age without fraud is sufficient to support an action" 24 *O. Jur.* 2d 634-635, Fraud & Deceit § 20.

A finding of compensatory damage is a *sine qua non* to recovery of punitive damages. Punitive damages are in turn, a *sine qua non* to recovery of attorneys' fees. Therefore, if the award of compensatory damages is held to be erroneous, the several questions we raise concerning application of the Washington and Ohio rules as to punitive damages and attorneys' fees become moot.

2. Resume of Pleadings and Proceedings

In January, 1963, Hilltop filed a complaint against some of the Smith partners, charging in four alternative claims, fraud, breach of contract, violation of the Ohio antitrust laws and violation of the Sherman Act (R. 1-14). Each claim was founded on allegations that the Smith firm had intentionally and maliciously produced a false report concerning the market potential of Nutwood Farms for regional shopping center purposes. Damages in the form of loss of real estate commissions were claimed by Hilltop because, it was asserted, Nutwood Farms was sold for less than its true value, in misplaced reliance on the false report.

In July, 1964, a first amended complaint was filed (R. 100-21). The sisters were joined as parties plaintiff, several additional Smith partners and corporate affiliates and Ray L. Treiger, the Smith employee who had been in charge of the Nutwood study, were added as de-

fendants, The Austin Company was added as a defendant as to the federal antitrust claim, and the prayer was increased from $1,312,500.00 to $8,862,500.00. This increase was on the assertion that Nutwood's real value had been $20,000 an acre (R. 110) instead of $6,000, as claimed in the original complaint (R. 6). Nutwood had been sold by the sisters to Ridge Hills Development Co. on April 29, 1960 for $3,500 an acre (A.F., App. 78-79).

On April 7, 1965, the district judge entered orders (R. 948-55) dismissing both the federal and state antitrust claims on summary judgment. Since The Austin Company had been joined only as to the claimed federal antitrust violation, it was dismissed with prejudice (R. 948-49). By orders entered June 10, 1965, the court also dismissed on summary judgment defendants Winmar Holding Company, Inc., a Smith affiliate, and Ray L. Treiger (R. 1026-27).

Oral Opinions and Memorandum Decisions

Immediately upon conclusion of the trial, which lasted twelve days, the court on August 6, 1965 expressed tentative opinions on the merits. Later, on October 29, 1965 and May 2, 1966, the court issued written memorandum decisions. The court did not enter findings apart from these two decisions. We have reproduced the two memorandum decisions verbatim and the essential parts of the tentative opinions and other observations of the court, as Part I of the Appendix filed with this brief.

Judgment

The court entered judgment on the fraud cause of action, in favor of Hilltop, for $2,920 compensatory damages and $40,000 punitive damages, against defendants Larry P. Smith, Frederick C. Arpke, Frank A. Orrico, Ian McConnachie and James O. York, and in the sisters' favor for $2,920 compensatory damages and $35,000 punitive damages. It also granted recovery of $75,000 to plaintiffs "as reasonable attorneys' fees' (R. 2149-50). It dismissed the remaining defendants.

It is from this judgment of May 13, 1966 that the present appeal was taken on May 13, 1966 (R. 2155-56). On June 13, 1966, plaintiffs cross appealed against all defendants, including The Austin Company (R. 2185-86).

3. Narrative of the Controversy:

Larry Smith & Company, a partnership, four of whose members and one of whose former members (Arpke) are the present appellants, is a real estate consulting firm which has as one specialty, feasibility studies on potential shopping center sites (L. Smith Tr. 2333-34). The methodology employed by Smith in making these studies was developed by Larry Smith, principal in the firm, after World War II (L. Smith Tr. 2340-48). Briefly stated, it involves development of statistical and economic information concerning an estimated "trade area" for a project site, determination of population levels past, present and future for that trade area, income levels for

trade area residents, retail expenditures made by trade area residents, and evaluation, by use of established yardsticks, of the effective competition to the proposed project. From this data, the Smith firm draws conclusions as to the possibility of developing a retail center at the site studied (Kelly Tr. 2130-32). As of the time it undertook the Nutwood analysis in December, 1959, the Smith firm had as partners Larry Smith, Frank Orrico and Frederick Arpke (A.F., App. 28-29). As of that time the firm had made between fifteen hundred and twenty-five hundred such studies (L. Smith Tr. 2336). It maintained offices in Seattle, Washington, D. C., New York, Chicago and elsewhere (A.F., App. 28). It had made analyses throughout the United States and various foreign countries (L. Smith Tr. 2336, Kelly Tr. 2125), principally for department stores and real estate developers. Department stores served by Smith include R. H. Macy, J. C. Penney, Gimbels, Strawbridge & Clothier of Philadelphia, J. L. Hudson of Detroit, Carson, Pirie & Scott of Chicago, Meier & Frank of Portland, Bullocks of Los Angeles, Montgomery Ward, Eatons of Canada, The Dayton Company of Minneapolis, The Myer Emporium of Melbourne, Australia, and many more (L. Smith Tr. 2335, Kelly Tr. 2125). It had also made land use or feasibility studies for insurance companies, banks and governmental agencies, such as the cities of Vancouver, B. C., Sacramento, Anchorage, Philadelphia, Baltimore, New Haven, Hartford, Boston, Detroit, Pittsburgh, Fort Worth and many

others (L. Smith Tr. 2332).

In 1959-1960 Smith was organized in two divisions, the Western Division with headquarters in Seattle, which was also the home office, and the Eastern Division with headquarters in Washington, D. C. (L. Smith Tr. 2333). All three partners lived in the Seattle area.

In charge of the Eastern Division was Harold R. Imus, then a senior associate (Imus Tr. 727). Under Imus were several account executives, a number of analysts or report writers, and various statistical clerks, field men and other supporting personnel (Steinberg Tr. 560).

Under date of September 14, 1959, Henry Petti, president of Hilltop, wrote to Smith's New York office asking for a quotation of fee to do a study of the Nutwood Farms site about 15 miles east of downtown Cleveland (A.F., App. 43). The inquiry was referred to the Washington, D. C. office. Imus in turn referred it to Ray L. Treiger, one of his account executives who had familiarity with Cleveland through work on a property known as Longwood or Severance, in Cleveland Heights. Treiger had worked since 1955 on studies of the property for The Austin Company, which had bought the property from Severance Millikin (A.F., App. 31-32). Treiger acknowledged Petti's inquiry by telephone and on September 24 wrote a memo to Ake Orndahl, manager of Smith's New York City office, in which he said in part:

> "I told Petti we were working on the Longwood [Severance] property and felt that there might be some conflict in our own position. He said that he did not think that there would be because he did not think that his property would pull very far from the west. He said he might pull 20 miles from the east, but if it went two miles to the west, he'd be lucky" (A.F., App. 44).

Severance is about seven miles southwest of Nutwood (A.F., App. 28). See Plate 1 of this brief.

Treiger ended his memo,

> "I am not sure I know how to handle this, in view of our possible investment position, and since this is your realm, I'd like to get your opinion on it" (A.F., App. 45).

At that time Orndahl was involved in negotiations looking to the possible purchase by the Smith firm of an interest in Severance Center (Orndahl Tr. 1119), a proposed shopping center in which The Higbee Company and Halle Brothers Company, two of the three leading Cleveland department stores, were publicly committed to build branches (A.F., App. 37-38).

On September 30, Treiger wrote a memorandum in part as follows concerning Hilltop's letter:

> "After speaking to Ake [Orndahl] on the 29th, I agreed that we ought to try and handle this inquiry. I spoke to Mr. Petti and told him that as long as he recognized the fact that we have been acting on the Severance Estate for some three years, we believed we could act for him . . ." (A.F., App. 46).

On the same day, September 30, Treiger wrote Hilltop

a letter proposal to make a "Shopping Center Analysis" of Nutwood for $4,500 (A.F., App. 45-46).

On October 5, in a telephone call from Treiger, Petti asked Treiger to come to Cleveland for a personal interview (A.F., App. 46-47). That interview, which was the only personal contact between the parties before Smith was retained and rendered its report, took place in Cleveland on October 8, 1959. Both Treiger and Wilbert O'Neill, attorney and business advisor for the sisters, wrote memoranda of the meeting (Treiger, A.F., App. 47; O'Neill, A.F., App. 47-49). The two memos are not in conflict as to what occurred. The part of O'Neill's memo which is relevant to the issue of disclosure follows:

> "I met yesterday with Messrs. Petti, Crume [secretary of Hilltop] and Ray L. Treiger, who represents Larry Smith & Co., real estate consultants of Washington, D. C. The meeting had been arranged by Mr. Petti with Mr. Treiger to discuss a proposal by Larry Smith & Co. for a survey to determine the availability of Nutwood as a site for a regional shopping center development.
>
> "Petti showed me proposals he had received from two other such consultants but the Smith proposal seemed most interesting, notwithstanding the fact that Smith & Co. had acted as consultants on whose advice at least partly the decision had been made by Higbee's and Halle's to go into the Longwood [Severance] development at Mayfield and Taylor Roads. Treiger told us that his company had become advisers on this Longwood project for the Austin Company and Severance Millikin, after the Longwood area had been zoned for retail development but with an exclusion of any super-market. The area of course has since been re-zoned to permit a super-

> market development, and after extensive litigation it was considered that it was legally possible now to go ahead with the Longwood development project. Treiger emphasized the possible conflict of interest between his firm's loyalty to Austin and Severance and any recommendations he might make to the promoters of the Nutwood project. I called Petti's attention to the fact that this loyalty to Austin and Severance might reasonably be expected to prevent Smith & Co. from making any recommendations or using other influence to induce Higbee, Halle or any other prospective tenant to go into a Nutwood development if that would interfere with their commitments to the Longwood project, but it was considered worth while to get Smith's survey and recommendations, having in mind that his work on the Longwood project had given him a great deal of background information, which would be useful on other phases of the project besides the matter of department store tenancies" (A.F., App. 47-49).

At the time of the October 8 visit, plaintiffs were negotiating with Edward J. DeBartolo, reputed by Petti to be the developer-owner of thirty shopping centers in northeast Ohio and Pennsylvania (Ex. 371, pp. 126-27; see A.F., App. 49). When these negotiations came to naught, Hilltop turned back to Smith's proposal and, on December 5, 1959, Petti hired Smith to study Nutwood (A.F., App. 53).

On December 11, 1959, John Marshall, economic analyst in the Washington office assigned to prepare the Nutwood analysis, issued field instructions to Tom Darmstadter, who was to do the field work for the report (A.F., App. 54-55). On December 22, upon returning from Cleveland, Darmstadter wrote a detailed memorandum to

Marshall (A.F., App. 55-58).

On January 4, Treiger informed Petti by phone that the Smith findings on Nutwood were negative. Treiger suggested that further refinement of details could not affect the general conclusions and suggested that Smith send Hilltop a memorandum explaining the conclusions, without writing a finished report. Petti concurred in this suggestion (A.F., App. 59).

On January 8, Smith mailed to Hilltop a written memorandum entitled "Shopping Center Opportunities at Nutwood Farms" (A.F., App. 59), in which Smith concluded that the effective competition was such that there was insufficient opportunity for a regional or intermediate shopping center at Nutwood, at least through 1970 (Ex. 29). The full text of this memorandum is printed in the appendix to this brief (App. 149-72). In view of the reduction of Smith's commitment from a full report to a memorandum, Smith reduced its fee from the agreed $4,500 to $2,920 (Ex. 7; See Ex. 29, App. 152).

Neither of the two key men assigned by Smith to the Nutwood study, John Marshall and Tom Darmstadter, knew until many months after the report was delivered to Hilltop that Smith had any idea of negotiating for a proprietary interest in Severance (Marshall Tr., App. 92; Darmstadter Tr., App. 95). Both Marshall and Darmstadter testified that the judgments exercised by them were not influenced in any way by their superiors

(Marshall Tr., App. 90; Darmstadter Tr., App. 94-95). Marshall testified that he reviewed his findings separately with Treiger and Imus, who suggested some very minor modifications (Tr., App. 90-92). Treiger, Marshall remembered, altered individual per capita expenditure patterns slightly, some up and some down, and made a slight downward revision of the effective competition Nutwood might expect from a given location because, "I was a little more fearful of competition than Mr. Treiger was" (Tr., App. 91).

At the time of trial, Marshall, who had a master's degree, held a position of price economist with the Bureau of Labor Statistics (Tr., App. 88) and Darmstadter was vice president in charge of the Property Management Division of The Lumberman's Company of Austin, Texas, a real estate development firm operating on a national basis (Tr., App. 92-93).

Hilltop's contacts with Larry Smith & Company were all through Ray Treiger, although certain other Smith employees, notably Imus, Marshall and Darmstadter, were involved. None of the then partners, Larry Smith, Frank Orrico and Frederick Arpke, was aware that the Nutwood analysis was being performed. Larry Smith first heard of Hilltop and Nutwood in late 1961 or 1962 (Tr., App. 133-35), Orrico sometime after the fall of 1960 (Tr., App. 138), and Arpke first heard of them "when litigation was threatened" (Tr., App. 145).

Following delivery of the Nutwood memorandum, Treiger went to Cleveland on January 18, 1960 and spent the afternoon with Petti and O'Neill, discussing alternative possibilities for development of the property. Treiger made a complete written memo of the meeting (A.F., App. 59-60) as, again, did O'Neill, in the form of a letter to the sisters dated January 22, 1960 (A.F., App. 64-69). As with the previous meeting of October 8, 1959, the memos of Treiger and O'Neill are not in conflict.

On January 13, 1960, the owners of Nutwood had received an offer, through Hilltop, of $3,500 an acre for the property from Harry Ratner, a Cleveland developer (A.F., App. 59). Treiger was not informed about this offer on the occasion of his visit five days later with Petti and O'Neill. Nor does the record show that Smith was ever asked any advice as to whether the owners should sell Nutwood, or for what price.

The Issue of Reliance As It May Affect This Appeal

In view of the district judge's findings that Smith's negative conclusions had not been proven incorrect and that plaintiffs had shown no damages in the sale of Nutwood, plaintiff's reliance or non-reliance on the report would not appear to be a live issue on this appeal (M.D., App. 10).

Absent a finding that plaintiffs' reliance on the report somehow damaged them, the issue of whether plaintiffs relied on the report or, for that matter, on Smith's non-

disclosure at the time Smith was employed, has no practical significance. Nevertheless, since the district judge, after "vacillation", found that Hilltop relied on the analysis in selling to Ridge Hills, we feel obliged to review the evidence on this score. It is not in serious conflict. It consists of Petti's own testimony, his letter to a Cleveland real estate firm, following receipt of the Smith memorandum, and the independent testimony of Karl Kammer, who acted as attorney for Ridge Hills. In sum, it shows that Petti relied upon the affirmative findings of Smith and rejected Smith's negative findings, in selling to Ridge Hills. As for the sisters, Mrs. Ashcraft, who was in Madrid and never read the report, relied on O'Neill and Petti (Tr., App. 126-27), and Mrs. Powell, who was in the Virgin Islands and never read the report, relied on Mrs. Ashcraft and O'Neill (Tr., App. 128). If O'Neill in turn relied on the report it was through Petti (See O'Neill, Tr. 1868-69). Therefore, the pivotal question as to all plaintiffs is whether Petti relied.

1. Petti's Testimony

Petti testified that he relied upon the Smith analysis only to the extent that it was favorable to Nutwood:

> "Q. (By Mr. White) Is it your testimony then, Mr. Petti, that you relied on the Smith report to the extent that it was favorable, namely, such aspects as good access, but did not rely on the negative aspect that there was too much competition?
>
> "A. I think that was precisely my conclusion as to

the report." (Tr., App. 114; also see Tr., App. 112).

As to competition, Petti stated that he believed Nutwood had none of any consequence:

"Q. . . . Did you believe at that time that Nutwood had no significant competition of a regional nature?"

* * *

"A. Yes, I did believe that it had no significant competition as a true regional site." (Tr., App. 115).

Petti represented Nutwood to a prospect as a good retail site on the heels of Treiger's visit to Cleveland on January 18, 1960 (Tr., App. 108). On a further occasion when he met with another prospective purchaser and real estate agent on January 25, 1960, two weeks after receiving the Smith report, Petti testified that he had agreed with them that Nutwood had great potential as a regional shopping center (Tr., App. 111).

2. Letters to Galvin & Cloak — Exhibits 348A & B

Before retaining Smith, Hilltop had compiled considerable data concerning what it conceived to be the Nutwood trade area (Petti Tr. 254). This material was sent to real estate firms, developers, department stores and anyone who might be interested in the site (See Chart, Appendix Part V). Among those who received letters was Donald Cloak of the Ostendorf-Morris Company, realtors in Cleveland. Petti wrote to Cloak on June 12,

1959, giving his standard sales pitch on Nutwood (Ex. 348B). On January 29, 1960, just eleven days after Treiger's trip to Cleveland to review with Petti Smith's memorandum on Nutwood, Petti wrote to Peter Galvin, another officer of Ostendorf-Morris (Ex. 348A).

Petti failed to produce either of the letters to Ostendorf-Morris (Exhibits 348A and 348B) in the extensive pretrial proceedings, despite the fact that they fell squarely within the subpoena duces tecum served on him for his deposition (Exhibit 363). Petti testified he understood he was to bring all such letters to his deposition (Tr. 272-73). It was only through the accident that defendants retained Edwin Smith, another officer of Ostendorf-Morris, as an expert witness on value, that the letters ever came to light. The two letters are, in our view, conclusive on the issue of reliance on the Smith analysis. We have, therefore, reproduced them on the following pages with a few added comments. It will be seen that Petti sang exactly the same tune about the great retail potential of Nutwood eleven days after receiving Smith's report as he had in June, 1959, three months before his initial contact with Smith. In addition, several new verses had been added. These Petti had copied from the affirmative findings of the Smith memorandum. It was a sales tool he had not had in June, 1959. Of course, he omitted any reference to Smith's negative conclusions. For example, the second, third and fourth paragraphs of the January letter are lifted from

crosses Bishop Road (Route 84), thus creating two interchanges on either end of the subject property

It is to be noted that the state actually will be acquiring 30 to 40 acres of the subject property We understand that appraisals in the area are now getting underway.

Mr Peter Galvin
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January 29, 1960

2. Nutwood is good for 1,000,000 square feet of retailing.

1. The Site. The plan demonstrates that the site can accommodate upwards of 1,000,000 square feet of retail building with parking for more than 6,500 cars. Nutwood might well support additional compatible development in the form of a motel or motel, office building, apartments and entertainment facilities such as a supper club, bowling alleys, legitimate theater or music hall, plus a couple or three service stations.

3. Petti says Nutwood is unique site for regional retail center, before and after Smith report.

2. Location. Nutwood enjoys a unique location for the development of a major retail center. It is adjacent to or in close proximity to principal existing traffic arteries. It will be adjacent to the Euclid Spur which will connect the North-South Thruway with the Lakeland Freeway. According to Albert Porter, Cuyahoga County Engineer, it is expected that most of the traffic from the east will enter Cleveland over the Spur. The Spur and Lakeland Freeway will provide the easiest access to downtown Cleveland for people in the Hillcrest and eastern areas, thus tending to develop the habit of a northerly movement of these people as opposed to a westerly or southerly movement. Richmond Heights and Highland Heights are anticipating increase in residential development when sanitary sewer facilities become available to them within the next couple of years. Residential development in western Lake and Geauga Counties is expected to continue. It is our considered opinion that this is the only location in the northeast area that is suitable for a regional center. If true, and we know of no other, this should provide insurance against significant competition of a regional nature

Petti uses Smith report, copies from page 1 of Ex. 29.

3. Trading Area. The total retail spending by trade area residents is substantial. In view of the distance of the trade area from downtown Cleveland (13 miles), it can be expected that very substantial purchases of total spending will be retained by local facilities (as opposed to facilities in downtown Cleveland). Thus the potential for suburban facilities is very significant.

In the immediate area surrounding Nutwood there are now well advanced plans for an industrial park and multi-million dollar apartment projects. With the new residential development which is almost certain to come nearby, Nutwood might well become the hub of a market area approaching 400,000 permanent residents and transients. Developed to its greatest potential it could become essentially a 'downtown' location yet serve and maintain the character of suburbia. Such a complex we believe to be consistent with new growth in expanding metropolitan areas. Much, of course, would depend on the nature of the architecture and on a well conceived plan designed to build in the intangibles which would make a visit to Nutwood an adventure, not only in shopping but also in living, an element of downtown which we overlook entirely or tend to minimize.

Mr. Donald Cloak Page 2

present no true regional shopping center and no major department store located in the northeast section of Greater Cleveland.

3. Location. Nutwood enjoys a unique location for the development of a major retail center. It is adjacent to or in close proximity to principle existing traffic arteries. It will be adjacent to the Euclid Spur which will connect the North-South Thruway with the Lakeland Freeway. According to Albert Porter, Cuyahoga County Engineer, it is expected that most of the traffic from the east will enter Cleveland over the Spur. The Spur and Lakeland Freeway will provide the easiest access to downtown Cleveland for people in the Hillcrest and eastern areas, thus tending to develop the habit of a northerly movement of these people as opposed to a westerly or southerly movement. Power, water and sewer facilities are available close by. Richmond Heights and Highland Heights are anticipating an unprecedented increase in residential development when sanitary sewer facilities become available in them within the next three years. Residential development in western Lake and Geauga Counties is expected to continue. It is our considered opinion that this is the only location in the northeast area that is suitable for a regional center. If true, and we know of no other, this should provide insurance against significant competition of a regional nature. At the same time, it strongly suggests that we should act in order to capitalize on an opportunity while it is still available.

4. Composition of Center. As established above, the area should support in the neighborhood of 1,000,000 square feet of stores made up as follows:

a. Two department stores containing 400,000 to 500,000 square feet. This should include a store such as Sears with one such as Taylor's or Sterling-Lindner's. Ideally one of these stores would anchor the center of either end.

b. An additional 400,000 to 500,000 square feet of complimentary facilities consisting of specialty stores, service shops and a limited number of convenience stores. These tenants should be financially sound and experienced merchandisers of proven capabilities -- preferably national or strong local chains.

As you are aware, the above is the result of thorough preliminary investigation. The figures and conclusions are derived from factual information, general experience and rule-of-thumb methods. Such methods have proven remarkably accurate in the past, and we are

Mr Peter Galvin
Page 3
January 29, 1960

4. Petti relies on own "investigation", Not on Ex. 29!

Our investigation indicates that all aspects of the subject lands are favorable to such a development The topography provides good gradients and natural drainage. The soil formations are suitable for sound low cost foundations and excavations. Power, sewer and water are available close by

We have in our possession, as of this writing, a market analysis by Larry Smith and Company, compiled in the last several months, plus a utilities study by the Frank A. Thomas and Associates, Engineers, for the City of Euclid, City of Wickliffe and Village of Willoughby Hills. If your clients are interested in this property, we are in a position to make this information available to them.

Nutwood asking price was increased from $3,500 to $3,750 an acre after Smith report.

The sale price at this time for the entire property, including land to be acquired by the state, (10 acres of which front on Euclid Avenue presently zoned to support 180 apartment units), is $3,750 per acre It is our opinion that a sale can be completed with approximately 29% down ($185,000) and the balance in 4 or 5 equal installments Only land to be acquired by the state of Ohio would be released on the initial down deposit. Suitable release terms for construction purposes can be arranged for the balance Money obtained from the state can be applied against the purchase price.

We are of the firm belief that all of the above strongly suggests that the time is here for someone to act in order to capitalize on an opportunity while it is still available.

Very truly yours,

HILLTOP REALTY, INC.

Henry Petti
President

HP:rmf
enc.
cc W Savage

Mr. Donald Cloak Page 3

confident that detailed studies, when completed, will produce equally as encouraging results. We have here a combination of circumstances that provides extremely favorable conditions for a most successful development.

Hope all of the above will bring you up-to-date and help you evaluate the great potential of our Nutwood Development, and, as I made known to you in your office, we would prefer to stay with the development and would be receptive to a joint venture with your company.

Kindest regards, I remain,

Very truly yours,

HILLTOP REALTY, INC.

Henry Petti
President

hp:rmls
enc.

PLATE 2

3 weeks after Petti received Smith Report, Ex. 29.

3 months before Petti made initial contact with Smith.

1. Petti says Nutwood is still a major retail center, despite Smith report.

Copied directly from Smith report, Ex. 29, page 1. Petti uses Ex. 29 as sales tool.

2. Nutwood is good for 1,000,000 square feet of retailing.

January 29, 1960

Mr Peter Galvin
c/o Ostendorf- Morris Co
33 Public Square
Cleveland, 15, Ohio

CAUSE 576
PLAINTIFF EXHIBIT 347(A)
ADMITTED JUL 22 1965

Dear Pete

I am enclosing for your information an area map and site plan, also a brief summary which we believe to represent the existing conditions and the collective thinking that has developed in the use of Nutwood farm development for a major retail center.

The subject property, as indicated on the map, consists of approximately 174 acres situated on the northwest corner of Chardon Road (U S. Highway 6) and Bishop Road (Ohio State Highway 84) in Lake County, about three miles east of the city limits of Cleveland. Actually, the Cuyahoga County line borders this property on the West.

This Nutwood Farm site is located adjacent to the proposed Euclid spur connecting Ohio State Route 1 (North-South Freeway) with the Lakeland Freeway. These two freeways have not been constructed to date, but it is estimated by the Ohio State Highway Department that the Euclid spur would be open to traffic by the end of 1962.

Access to the site may be considered to be excellent. The property will have frontage on the three highways mentioned above (Routes 6 and 84 and the spur connecting the two freeways), plus excellent access from Euclid Avenue (U S 20), a major six-lane artery, via the Euclid spur. The highway department has indicated plans for a four-ramp cloverleaf at the point where the Euclid spur crosses Bishop Road (Route 84), thus creating two interchanges on either end of the subject property.

It is to be noted that the state actually will be acquiring 30 to 40 acres of the subject property. We understand that appraisals in the area are now getting underway.

Mr. Peter Galvin
Page 2
January 29, 1960

1. The Site. The plan demonstrates that the site can accommodate upwards of 1,000,000 square feet of retail building with parking for more than 6,500 cars. Nutwood might well support additional compatible development in the form of a hotel or motel, office building, apartments

Hilltop Realty Inc.
HILLCREST 2-0700
8088 MAYFIELD ROAD
LYNDHURST 24, OHIO

June 12, 1959

CAUSE 576
PLAINTIFF EXHIBIT 347(B)
ADMITTED JUL 22 1965

Mr. Donald Cloak,
Ostendorf-Morris Company,
33 Public Square,
Cleveland, Ohio

Dear Don:

I am enclosing as per your request, an area map, site plan and isochron chart, also a brief summary which we believe to represent the existing conditions and the collective thinking that has developed in the use of Nutwood Farm development for a major retail center.

1. The Site. The plan demonstrates that the site can accommodate upwards of 1,000,000 square feet of retail building with parking for more than 6500 cars. Nutwood might well support additional compatible development in the form of a hotel or motel, office building, apartments, and entertainment facilities such as a supper club, bowling alleys, and a legitimate theater or music hall.

2. The Market. The isochron chart shows the area lying within 15 minutes driving time of the proposed center. Actually, the primary market area of this center will extend at least 30 minutes to the east, if not as far to the south and west. Within slightly more than 15 minutes distance there was in 1956 about 90,000 family units. It is estimated that this figure will increase to approximately 130,000 during the 1965-70 period. Based on average per family retail purchases of about $4700 for Cuyahoga County and $3900 for Lake County, a market of from $350,000,000 to $450,000,000 would seem to be indicated. The amount of this market that is presently being served by existing retail outlets has not yet been determined. However, to capture only a modest percentage of this potential would result in substantial volume.

These, of course, are estimates derived from preliminary study. But, by its regional nature, this center will draw trade for shopping goods from well beyond the 15 minutes limit, and thereby tap a potential that has not been considered in the above figures. Therefore, we believe these figures to be conservative. Furthermore, there is at

Mr. Donald Cloak Page 2

present no true regional shopping center and no major department store located in the northeast section of Greater Cleveland.

3. Location. Nutwood enjoys a unique location for the development of a major retail center. It is adjacent to or in close proximity to principle existing traffic arteries. It will be adjacent to the Euclid

the Smith memorandum (App. 154). So is the first paragraph under "Trading Area" (App. 154). The second paragraph under "Trading Area" is taken from earlier letters by Petti to retailers. For example, see the next to the last paragraph of Petti's letter to a prospect dated November 22, 1958, where he said that the "intangibles" would make "a visit to Nutwood an adventure not only in shopping but in living" (Ex. 371, p. 57).

Exhibits 348A and 348B give the lie so directly to plaintiffs' basic position that they relied on the Smith report that Petti had ample motive to suppress them. The incident casts a dark shadow on Petti's integrity but, far more important, it erases any possible problem in choosing between the testimony of Petti and Karl Kammer as to the Ridge Hills negotiations.

3. Testimony of Karl Kammer

Karl Kammer, a Cleveland attorney, was an officer and general counsel of Ridge Hills since its inception. The two principals in Ridge Hills, Harry Ratner and Fred Stark, were both deceased at the time of trial (Petti Tr., App. 104; Kammer Tr. 1636-1637). Kammer testified that Ridge Hills' negotiations with Petti for Nutwood had commenced "for at least a period of several weeks, perhaps a few months" before January 13, 1960, the date of Harry Ratner's original offer (Tr., App. 119). Petti told the Ridge Hills people, who were, according to Petti's earlier false testimony, only interested in the

property for residential purposes (Petti Tr. 378), of the tremendous potential of the property as "one of the finest areas in perhaps the State of Ohio for a shopping center" (Tr., App. 119).

Kammer met with Petti "three or four times" between January 13 and April 29, 1960 (Tr., App. 121). Petti continued to make the same statements as to the potential of Nutwood that he had made prior to January 13 (Tr., App. 120-21). Petti during these meetings proposed that he become the leasing agent for the new owners in obtaining "department stores and other leases of a major nature" (Tr., App. 121).

Ridge Hills at all times between January 13 and April 29 informed Petti that it intended to "put Nutwood to use as a regional complex consisting of a major shopping center of the regional type . . ." (Tr., App. 121-22). Petti never, at any time, in Kammer's presence, expressed any doubt with respect to the use of Nutwood for a regional shopping center (Tr., App. 122).

Petti acted for the new owners in promoting Nutwood as a regional shopping center "from the inception of our negotiations through that period of time that he was given an exclusive," (Tr., App. 123). This would, of course, embrace the period before, during, and after the Smith analysis, until the expiration of Hilltop's exclusive agency on April 27, 1962 (A. F., App. 87). On cross examination, Kammer repeated that the negotiations with Ridge Hills which led to the sale commenced several

weeks before January 13, 1960 and, therefore, several weeks before the Smith study was furnishd to Hilltop (Tr., App. 119). Plaintiffs did not cross examine Kammer at all concerning the representations made by Petti.

As was true during his efforts to interest retailers in Nutwood for the two years before the Ridge Hills sale, Petti found in his efforts for the two years following the sale that no one was interested in Nutwood (Tr. 436).

Smith's Relationship to Severance

Severance Millikin owned a 151-acre residential estate, "Longwood," located in Cleveland Heights, in the middle of a densely populated and prosperous area some seven or eight straight line miles east of downtown Cleveland (A.F., App. 28, 30; Walton Tr. 2066-67). This property later became known as "Severance." In 1954, Millikin employed The Austin Company, a large firm of builders with headquarters in Cleveland, to have the property rezoned. The property was rezoned for development as a shopping center on December 20, 1954. A taxpayer's action was brought attacking the rezoning. Rezoning was finally upheld on December 18, 1957 by the Supreme Court of Ohio (A.F., App. 30). After the 1954 rezoning, Millikin indicated that he desired Austin to carry out the development of the property (A.F., App. 17). Title to Severance was transferred to a corporation in which Austin held a 75% interest and Millikin 25% (A.F., App. 31-32).

In May, 1955 Austin employed Smith on a monthly retainer basis as its consultant in connection with Severance. Smith prepared a number of economic analyses which expressed its opinion that the site was well adapted to the development of a large regional shopping center (A.F., App. 31).

In May, 1958 the directors of Austin resolved not to develop Severance as a shopping center for Austin's account, due to lack of personnel familiar with that business. Accordingly, Austin decided to sell and asked Smith to help in obtaining a buyer for Austin's interest (A.F., App. 33).

In December, 1958, Smith began considering the possibility of itself joining in the purchase of an interest in Severance, and in January, 1959 began exploring the possibility of financing such a venture (A.F., App. 37).

On February 22, 1959, the Cleveland papers announced that Halle Bros. Co. and The Higbee Co., two of the three leading department stores in Cleveland, would build branches at Severance, and were negotiating contracts to this end with Austin (A.F., App. 37-38). The May Company, the third such store, had in 1958 opened a branch at Cedar Center, 1.5 miles from Severance (Kelly Tr. 2173), the largest branch store in Eastern Cleveland (Ex. 29, App., 160; see Plate 1 to this brief).

As of July 31, 1959, the retainer relationship between Smith and Austin was terminated. Austin and Smith were

then engaged in active negotiations for the sale of Severance to Smith. Austin advised Smith that if Smith did not become the purchaser of Severance it would be compensated for its services after July 31, 1959 (A.F., App. 42-43, 51).

From the outset of negotiations to the closing of the sale in July, 1960, Austin required that discussions on the sale of Severance be kept confidential (Ex. 274, p. 16-18, numbered from back of file; R. 1180; Ex. 84; Ex. 97, p. 10, numbered from back of file).

On February 10, 1960 Smith and Austin executed an agreement which, in effect, gave Smith an option to purchase Severance. This agreement provided that all publicity be subject to Austin approval until there should be a final closing (Ex. 77, p. 6).

On March 4, 1960, Lambert & Company, whom Smith had hoped would finance and participate in the transaction, informed Smith that it was not interested in the Severance project (A.F., App. 77).

Financing was finally arranged through another source and the corporate documents of Severance Estate, Inc. were delivered to Smith on July 21, 1960 (Ex. 282). Accordingly, a news release was issued to the Cleveland newspapers, which was printed on July 21, 1960 (Ex. 323). On that date an article appeared in the Cleveland Plain Dealer announcing the start of the Severance Shop-

ping Center and mentioning that Smith was owner and developer of the Center. (A.F., App. 79).

Further Meetings of the Parties Re Smith's Relationship to Severance

On August 2, 1960, Petti sent a letter which had been drafted by O'Neill, to Smith, attention of Ray L. Treiger, in which, referring to the public announcement of Smith's interest in Severance, stated that it was causing "real embarrassment with my clients," asking for "a full explanation of your position" (A.F., App. 79-80). In response, Treiger went to Cleveland and had dinner with Petti and O'Neill on either August 10 or August 12 (A.F., App. 84-85; O'Neill Tr., App. 129). Petti had in the interim learned that Smith had been negotiating on Severance when it was retained by Hilltop. Petti complained of this fact to O'Neill on the way to meet Treiger at the Sheraton-Cleveland Hotel, and complained to Treiger of this fact when they met that evening (O'Neill Tr., App. 129-30). At the dinner meeting Treiger stated Smith's position and left Petti and O'Neill with a written summary of it (A.F., App. 80-85). Basically, that position was that Smith had made in 1959 a full disclosure of its existing relationship to Severance and "that we were still actively working on the project" (A.F., App. 81). Treiger's disclosure of the continuing consulting relationship to Severance was confirmed by the testimony of Crume, secretary of Hilltop (Tr., App. 96). At the dinner meet-

ing, Treiger defended the objectivity and accuracy of the Nutwood report and, in the memorandum left with Petti and O'Neill, wrote:

> "Our responsibility to a client, particularly under a long-term consulting relationship, cannot be less than it would be to ourselves under a proprietary interest." (A.F., App. 81).

On September 17, 1960, Petti again wrote to Treiger, asking for answers to various questions regarding the chronology of the relationship between Smith and Austin (A.F., App. 85-86). On October 20, 1960, general counsel for Hilltop wrote a follow-up letter to Treiger (A.F., App. 86-87).

In view of Hilltop's questions, Imus and Treiger decided to investigate the adequacy of the original study (A.F., R. 1252). This review study was assigned to Everett Steichen, a senior associate who had not participated in any manner in the original study (Tr. 2044).

On February 15, 1961, Herbert Spring, Smith's Cleveland attorney, called a meeting in his office with O'Neill and Petti, Marvin Zelman, general counsel for Hilltop, and Steichen. At this time plaintiffs' representatives were given the "Review Memorandum" of Nutwood (Ex. 10) which had been prepared under Steichen (A.F., App. 87). O'Neill testified concerning this meeting as to Smith's attorney's responses to questions about the Smith-Austin relationship that Spring had responded fully and frankly (Tr. 2666-67).

Neither Smith nor its lawyers heard again from plaintiffs or their lawyers for almost two years. Then, on January 4, 1963, almost three years to the day after the Nutwood report was delivered, Hilltop commenced this action.

SPECIFICATION OF ERRORS*

1. The court erred in finding that plaintiffs had proved all elements of a cause of action for actual fraud, including intent to deceive, materiality, reliance and damage (M.D., App. 10-12).

2. The court erred in awarding compensatory damages to plaintiffs (M.D., App. 12, 16, 25).

3. The court erred in measuring compensatory damages as though the action were one for rescission (M.D., App. 12, 16, 25).

4. The court erred in finding that Hilltop was obligated to provide a market report to Mesdames Ashcraft and Powell (M.D., App. 12, 17).

5. The court erred in assessing punitive damages in this diversity action:

(a) A Washington judge would refuse to apply Ohio law, which permits punitive damages, in the face of

*The findings to which the specification of errors is directed are italicized in the memorandum decisions reprinted in the Appendix hereto, with notation as to the specification numbers.

the Washington public policy forbidding such awards.

(b) Even assuming Washington would apply Ohio law, under the law of that state imposition of punitive damages would not be justified. The court's characterization of defendants' non-disclosure as "gross fraud" is in any event clearly erroneous and inconsistent with the facts found by it (M.D., App. 12, 22, 25).

6. The court erred in holding that nominal damages will support an award of punitive damages, under Ohio law (M.D., App. 13).

7. The court erred in awarding punitive damages and attorneys' fees to plaintiffs in the absence of proof of actual malice, a requirement under Ohio law (M.D., App. 12, 22).

8. The court erred in concluding that under Ohio law punitive damages need not bear any reasonable relationship to compensatory damages (M.D., App. 23).

9. The court erred in finding that plaintiffs were justified in bringing this action because of defendants' failure to disclose facts to plaintiffs before suit (M.D., App. 14, 17).

10. The court erred in concluding that in light of its finding that plaintiffs were justified in commencing this action, they should be awarded their costs of litigation, as punitive damages, together with reasonable attorneys'

fees, and in making such awards (M.D., App. 14, 17, 25, 26).

11. The court erred in finding that one or more of the present appellants was aware of the nondisclosure or of Treiger's August, 1960 meeting with plaintiffs (M.D., App. 13).

12. The court erred in finding that any of the present appellants authorized or ratified the non-disclosure or that any of them are liable for punitive damages on a theory of *respondeat superior* (M.D., App. 13).

SUMMARY OF ARGUMENT

Specification of Error No. 1

The court concluded "that all eight elements of [actual] fraud under Ohio law have been proven by clear, cogent and convincing evidence" (M.D., App. 12). This conclusion is incompatible with the facts found by the court and is contrary to undisputed evidence, including admissions of the plaintiffs. Four elements of actual fraud were lacking, namely, intent to deceive, materiality, reliance and damage.

(a) Intent to Deceive:

The court found that Smith's nondisclosure of the Severance negotiations was intentional rather than inadvertent (M.D., App. 11; O.O., App. 2). But the intent requisite for actual fraud is a bad faith intent to deceive,

not merely that the act be consciously done. In 24 *O. Jur.* 2d 622, Fraud & Deceit § 5, the author writes:

> ". . . actual fraud involves moral guilt or intention to do wrong, positive, actual fraud being any cunning, deception, or artifice used to circumvent, cheat, or deceive."

The court found that Smith, in not disclosing that it might buy Severance, was not actuated by malice or ill will (M.D., App. 17-18), by any intent to overreach Hilltop or any intent to make any pecuniary gain (O.O., App. 2, 8, 15). Rather, the court found Smith's sole motive was to carry out a commitment to The Austin Company to keep the negotiations confidential (O.O., App. 2, 15). As to the report itself, all of the judgments expressed were reached by employees who had no knowledge that Smith had any potential relationship to Severance other than as consultant to Austin (Marshall Tr., App. 92; Darmstadter Tr., App. 95).

At the close of the two and one-half week trial, the court was "of the very definite opinion that the concealment in law amounted to constructive fraud" (O.O., App. 2). Under Ohio law, constructive fraud will not justify the imposition of punitive damages. 25 *O. Jur.* 2d 34, Fraud & Deceit § 205. The distinction between actual and constructive fraud is expressed in 24 *O. Jur.* 2d 622-623, Fraud & Deceit § 5:

> "Actual fraud must affect the conscience and involve wilful deception, while constructive or legal fraud may arise from the circumstances of the trans-

> action or of the relationship of the parties, without the existence of fraudulent intent affecting the conscience."

The trial court's findings on evidence negate any conclusion that Smith had any fraudulent intent.

(b) Materiality:

In determining whether the element of materiality was proven clearly, cogently and convincingly, one must inquire whether Hilltop would have employed Smith if it had known of Smith's interest in acquiring Severance. On this score, all relevant evidence indicates that such knowledge would not have affected Hilltop's decision to employ Smith:

(1) O'Neill's memorandum of the October 8, 1959 meeting with Treiger shows that he and Petti decided to hire Smith despite their view that Smith's loyalty to Austin would "prevent Smith & Company from making any recommendations . . . if [they] would interfere with their commitments on the Longwood [Severance] project . . ." (A.F., App. 48).

(2) Before, during and after Petti hired Smith, he firmly believed that Nutwood and Severance were non-competitive. Even when he testified at trial, Petti still believed that Nutwood did not conflict with Severance (Tr., App. 96-98). Since Petti believed Severance to be non-competitive, whether Smith was a consultant to

Austin or a prospective purchaser of Severance, was immaterial to Petti.

(c) Reliance:

It was reliance by plaintiffs on Smith's nondisclosure, not reliance by them on the Smith report which the district judge held constituted the element of reliance (M.D., App. 11-12). More or less parenthetically and in a different context the judge found that plaintiffs relied on the conclusions of the Nutwood study in selling the property (M.D., App. 10). We make brief note of the effect of reliance:

(1) On the Nutwood Memorandum

The court's finding that plaintiffs relied on the conclusions of the report is irrelevant to actual fraud since the court also found that the conclusions of the report had not been proven incorrect and that plaintiffs' assertions that they were damaged by their reliance were "no more than speculation or conjecture" (M.D., App. 10). Further, the court's finding of reliance on the conclusions of the report, irrelevant though it be, is contrary to the undisputed facts.

(2) On Nondisclosure

If plaintiffs did not rely on the report, whether they relied on Smith's statement that it was a consultant on

Severance is immaterial. To cite an illustration after the manner of the American Law Institute:

> H employs a stockbroker S, to furnish him with advice. On the advice of S, H purchases stock in X corporation. S's advice proves to be sound. H later learns that S has acquired an interest in X corporation and that he was negotiating for same when he advised H. H. sues S for for damages. S is not liable to H irrespective of whether a court finds that, in employing S, H relied on S's nondisclosure.

In short, it is almost too plain to argue that reliance upon the status of someone in ordering a service is an insufficient element of reliance in a damage action based on actual fraud unless it be further shown that the aggrieved party relied upon the service actually rendered and incurred damages thereby.

(d) Damages:

It is axiomatic that actual damage is an essential element of actual fraud. As we shall demonstrate in our argument in support of Specification of Errors Nos. 2, 3 and 4, no such damages were proven. Indeed the findings on evidence by the district judge are impossible to harmonize with a finding of actual damage.

SPECIFICATION OF ERRORS NOS. 2, 3 & 4

The trial court's findings of fact add up to the classic definition of nominal damages:

> "Nominal damages are those recoverable when a legal right is to be vindicated against an invasion

> that has produced no actual loss of any kind, or where from the nature of the case some injury has been done, the amount of which the proof fails to show" 16 *O. Jur.* 2d 139, Damages § 3.

The court found that Smith had violated a right of Hilltop and of the sisters to know that Smith might buy Severance. The court found further that they were not damaged in selling Nutwood on the strength of the report because (a) the conclusions of the report were sound, and, anyway (b) Nutwood was not worth any more than the price paid by Ridge Hills. The court's rationale in awarding compensatory damages was indicated where it found that:

> ". . . there is sufficient evidence in the record to support a finding that the fair market value to the sisters of a reliable and trustworthy Nutwood market analysis was at least equal to the price which Larry Smith & Co. billed Hilltop for their analysis, or $2,920.00" (M.D., App. 16).

The court made no identification whatsoever of what this "sufficient evidence" might be. There simply is no such evidence in the record, as the court itself had observed in its first memorandum decision (M.D., App. 12), wherein the court found that it could not "from the evidence ascertain what value a reliable market analysis had to the sisters . . ." (M.D., App. 12).

Assuming for argument that a "reliable" and factually unassailable analysis was worth $2,920.00 to the sisters, why wouldn't an "unreliable" and factually unassailable analysis be worth just as much? Whatever use the sisters

made of the report, and the record is that neither ever read it (Ashcraft Tr., App. 126-27; Powell Tr., App. 128), their claim is that they used it as a reliable and factually unassailable report. They did not learn of Smith's negotiations on Severance until after they sold Nutwood. Hence, no action or inaction by them, or by O'Neill, could be predicated on their view that the analysis was untrustworthy.

The court measured damages as though the action were one for rescission or restitution. Yet, rescission was not pleaded. Hilltop never asked for its money back. Instead, it elected to pursue a remedy of damages. It confirmed its agreement with Smith by using the affirmative findings of the Smith report, both in selling to Ridge Hills, and in its vain efforts from 1960-1962 on behalf of Ridge Hills, to develop Nutwood as a retail center. The question arises:

How can a remedy of restitution be applied when it was never prayed for, when Hilltop elected an inconsistent remedy, when Hilltop used the report extensively and is in no position to return it, and, most important of all, when Hilltop received exactly what it sought, a valid and correct report, prepared objectively by Smith employees who were unaware that Smith had any connection with Severance, except as consultant?

More remarkable still is the court's award of $2,920.00 to the sisters. All of the reasons why rescission was im-

properly granted Hilltop apply to the sisters. In addition, the sisters had no contractual relationship to Smith, and as the court found, they were in no sense third party beneficiaries of the Smith-Hilltop agreement (O.O., App. 3, 6-7).

SPECIFICATION OF ERROR NO. 5

(a) In this diversity action, the law of Washington, the forum state, controls the choice of law to be applied on damages. Washington law forbids punitive damages as a matter of strong public policy. That a Washington judge, sitting in this case, would refuse to apply the Ohio law of punitive damages is clear under the Restatement, Conflict of Laws, often relied on by the Washington Supreme Court in resolving similar questions, and under analogous Washington precedents. In addition, exemplary damages are regarded as penal in character. It is axiomatic that an action may not be maintained to recover a penalty, the right to which is given by the law of another state.

(b) Even if Ohio law be applicable, the record is devoid of facts which would support a finding of punitive damages. The district judge's own findings are incompatible with its conclusion that defendants were "guilty of 'extreme and exceptional conduct' constituting a 'gross fraud' which was 'intentional and deliberate'" (M.D., App. 22). These epithetical characterizations of defendants' conduct are not supported by any factual findings, except that Smith did not disclose its negotiations on

Severance, which the court had felt, upon conclusion of the trial, amounted to "constructive fraud". The conclusion by the trial judge, almost a year later, that this same conduct was "gross fraud" and not "constructive fraud" is inconsistent with the facts found by the judge.

SPECIFICATION OF ERROR NO. 6

While the court in its final memorandum opinion awarded more than nominal damages to both plaintiffs, in its initial decision it concluded that "*Schumacher v. Seifert,* 172 N.E. 420 (Ohio Ct. App. 1930), authorizes an award of punitive damages where, as here, actual though nominal damage is found" (M.D., App. 13). This finding may be moot in view of the judge's later retraction of his statement that the damages to the sisters were nominal. However, since this court might possibly view the facts differently, we believe that a discussion of the Ohio law on this point is appropriate. In summary, the Ohio cases hold that punitive damages may be authorized where actual, demonstrable, tangible damages are proved, even though the amount awarded be "nominal" in the sense that it is small. On the other hand, the requirement of actual damages is not satisfied by an award of nominal damages based upon a bare violation of legal rights.

SPECIFICATION OF ERROR NO. 7

The court specifically found that defendants' conduct was not motivated by "actual malice, i.e., 'ill will or hatred'" (M.D., App. 17-18), but concluded that *Saber-*

ton v. Greenwald, 146 Ohio St. 414, 66 N.E.2d 224 (1946) authorizes punitive damages without a showing of "ill will or hatred" (M.D., App. 22).

Ohio law always has been that punitive damages could not be awarded in a bare case of fraud, but that some element of aggravation had to be present. Recent cases have established that the aggravating element required is actual malice, so that in order to award punitive damages the trier of fact must find actual fraud *and* actual malice. *Saberton* is not to the contrary.

SPECIFICATION OF ERROR NO. 8

Ohio, in common with many other jurisdictions, requires that, where punitive damages are awarded, they must be in reasonable proportion to the compensatory damages proved. This is called "The Ratio Rule". The court relied in its Final Memorandum Decision on *Saberton v. Greenwald,* 146 Ohio St. 414, 66 N.E. 2d 224 (1946) where the Supreme Court of Ohio reversed, 4-3, a trial judge's refusal to instruct on punitive damages. In that case a verdict of $38.15 compensatory damages had been returned and plaintiff had asked for $5,000 punitive damages. The district judge somehow read into this opinion a disapproval of the ratio rule (M.D., App. 23), despite the fact that the issue was not before the court. In our view, this action of the Ohio court, in a case where no issue was raised as to the "Ratio Rule", cannot be construed as a departure from

that rule. Further, the Ohio Supreme Court expressly approved the rule three years after *Saberton* in *Richard v. Hunter,* 151 Ohio St. 185, 85 N.E. 2d 109, 112 (1949). Finally, plaintiffs themselves recognized Ohio's adherence to the "Ratio Rule", in filing a motion that attorneys' fees be classified as compensatory damages for purposes of the "ratio of 'compensatory' and 'punitive' damages . . ." (R. 2018-20).

SPECIFICATION OF ERRORS NOS. 9 & 10

The court's stated reasons for imposing punitive damages on defendants — in the form of litigation costs and attorneys' fees — was that defendants "caused" the lawsuit (M.D., App. 14, 17). In turn, the underlying reason for the court's punishment of defendants — the reason why defendants caused the lawsuit, was said to be defendants' failure to disclose facts to plaintiffs before suit. We are completely at a loss to understand either the factual basis or the legal relevance of the court's views. Plaintiffs' own counsel and business advisor, Wilbert J. O'Neill, testified that defendants' attorney, Herbert Spring, at a meeting in Cleveland on February 15, 1961, attended by Petti and the general counsel of Hilltop, answered all questions fully and fairly. O'Neill testified in answer to a question from plaintiffs' trial counsel, as to what happened at the meeting:

> "Well, Spring said something to the effect that he wondered what the difficulty was, and I told him that the difficulty was very simply stated that they had

> accepted employment for professional purpose for pay at a time when they were already negotiating to buy property which we thought was conflicting property, and I asked him if I wasn't right, and when the negotiations began, and Spring, I thought, quite frankly, said that the negotiations by Larry Smith & Company to acquire from The Austin Company the Severance property, shopping center property, had been going on — my recollection is March 29, 1959, but things I have heard since indicate to me that, perhaps, it was May 29. I asked him whether the deal wasn't actually closed, and he said that it was closed on February 10, 1960, . . ." (Tr. 2666-67).

The district judge made it plain in his memorandum decisions that he was assessing costs of litigation and attorneys' fees against defendants under the label, "Punitive Damages". For example, the award of punitive damages was "conditioned upon plaintiffs' filing of a waiver of any claim to costs in this action" (M.D., App. 25-26). Plaintiffs accordingly filed a "Waiver of Costs" (R. 2136-37). The amount of "punitive damages" awarded was $75,000. The total amount of costs allegedly incurred by plaintiffs was $72,406.42 (R. 2025-26). The court even assesed against defendants under the guise of punitive damages the expenses and attorneys' fees allegedly incurred by plaintiffs in prosecuting their specious antitrust claims, despite the fact that it had dismissed plaintiffs' antitrust claims a year before trial (R. 950-53).

SPECIFICATION OF ERRORS NOS. 11 & 12

The court found appellants liable for punitive damages because of the acts of Treiger, their employee (M.D.,

App. 13-14). The grounds of the court's finding are not clear. Insofar as the court concluded that the partners could be liable for punitive damages on *respondeat superior*, it was in error. Ohio law forbids imposition of punitive damages on a principal because of an agent's acts unless the principal has authorized, ratified or participated in the wrong. *Tracy v. Athens & Pomeroy C. & L. Co.*, 115 Ohio St. 298, 152 N.E. 641 (1926). Insofar as the court found authorization or ratification, the finding is clearly erroneous, since the uncontroverted evidence is to the contrary. As to the apparent finding of authorization, the court's finding is even inconsistent with his oral remarks at the close of trial, wherein he observed that there appeared to be no evidence of authorization (O.O., App. 6).

ARGUMENT

I. The Court's Conclusion that Appellants are Liable for Actual Fraud Is Contrary to the Court's Own Findings and to Uncontroverted Evidence (Specification of Error No. 1)

A. Introduction

The trial judge recognized that this appeal would involve basically questions whether its conclusions of law were properly drawn from the virtually undisputed facts. In the hearing on presentation of judgment, the court observed:

"THE COURT: The way I view this, Mr. White,

> you are in the rather fortunate position, I think, as far as an appeal is concerned, that for the most part anyhow an appeal on your part would involve only questions of law on which the Court of Appeals may very well differ with me. Mr. Stephan is in the less happy position if he wants to appeal in that his appeal would involve questions of fact. I largely found against him on the main cause of action, and on the agreed facts in the pretrial order there is no question of credibility, so the Court of Appeals, irrespective of how I treated them, could take a different view" (Tr. 2165-66).

This appeal turns largely on whether the court's conclusion that defendants were liable for actual fraud (M.D., App. 11, 12, 22) is suported by clear, cogent and convincing evidence as to each element.

The court's findings as to four of the elements, namely, intent to deceive, materiality, reliance and financial injury, are unsupported by or clearly contrary to the evidence. In addition, the ultimate findings of intent to deceive, reliance and financial injury are inconsistent with evidentiary findings of the court.

Since jurisdiction rests on diversity, most matters of substance are controlled by the law of Ohio, the situs of the alleged tort. However, matters of procedure, including quantum of evidence required, are governed by the law of Washington, the forum state. Restatement, Conflict of Laws § 595 and Comment a thereto (1934). In Washington, every element of a cause of action for fraud must be proved by clear, cogent and convincing evidence. *Baertschi v. Jordan,* 68 Wn. Dec. 2d 451, 413

P.2d 657 (1966); *Anderson v. General Motors*, 161 F. Supp. 668 (W.D. Wash. 1958), aff'd. 275 F. 2nd 63 (9th Cir. 1960). In fact, as stated in *Asheim v. Pigeon Hole Parking, Inc.*, 175 F. Supp. 320 (E.D. Wash. 1959), aff'd 283 F. 2d 288 (9th Cir. 1960):

> ". . . The burden of proof upon the plaintiff is particularly heavy because, in Washington, as in many jurisdictions, the presumption of innocence of fraud is almost as strong as 'the presumption ° ° ° of innocence of crime.'"

In Ohio, as elsewhere, certain elements are necessary to prove actual fraud. All must be shown by the requisite quantum of proof. The absence of one of them is fatal. 24 *O. Jur.* 2d 635, Fraud & Deceit § 20. The instant record reveals that four of the essential ingredients are missing.

B. Intent to Deceive, a Necessary Element of Actual Fraud, Is Lacking

Under Ohio law, actual, rather than constructive, fraud is required to support an action for damages for deceit. *Lake Hiawatha Park Assn. v. Knox County Agr. Soc.*, 28 Ohio App. 289, 162 N.E. 653 (1927); *Fillegar v. Walker*, 54 Ohio App. 262, 6 N.E. 2d 1010 (1936); 24 *O. Jur.* 2d, 622, 634-35, 703-04, Frand & Deceit § § 5, 20, 109. In fact, it is the element of intent to deceive which distinguishes actual from constructive fraud. *Kuehner v. Johnson*, 33 Ohio L. Abs. 401, 34 N.E. 2d 996, 1003 (1940). "Intent to deceive" involves something more than that an act be consciously done. *Green Bay Auto*

Distributors v. Willys-Overland Motors, Inc., 102 F. Supp. 151 (W.D. Ohio 1951), aff'd per curiam, 202 F. 2d 151 (6th Cir. 1953); 24 *O. Jur.* 2d 622, Fraud & Deceit § 5.

Phrased another way:

> ". . . to constitute a cause of action [for actual fraud], there must be bad faith" 24 *O. Jur.* 2d 709, Fraud & Deceit § 116.

The Ohio Supreme Court defined "bad faith" in *Slater v. Motorists Mutual Ins. Co.*, 174 Ohio St. 148, 187 N.E. 2d 45 (1962). Syllabus 2 written by the court reads:

> "2. A lack of good faith is the equivalent of bad faith, and bad faith, although not susceptible of concrete definition, embraces more than bad judgment or negligence. It imports a dishonest purpose, moral obliquity, conscious wrongdoing, breach of a known duty through some ulterior motive or ill will partaking of the nature of fraud. It also embraces actual intent to mislead or deceive another."

It is easy to second guess the decision to take on the Nutwood study. But it should be remembered that Petti told Treiger in their first telephone conversation, after Treiger warned him that:

> ". . . We are working on the Longwood property and felt that there may be some conflict in our own position. . . ",

that he thought there would be no conflict because:

> ". . . he did not think his property would pull very far from the west" (A.F., App. 44).

O'Neill's memo of the October 8, 1959 meeting with Treiger says:

> "Treiger emphasized the possible conflict of interest between his firm's loyalty to Austin and Severance and any recommendations he might make to the promoters of the Nutwood project . . ." (A.F., App. 48).

If Treiger had a "dishonest purpose" as required in the Ohio Supreme Court's definition of bad faith, he would not have emphasized the possible conflict of interest. He would have played it down. He would not have emphasized his firm's loyalty and commitment to Severance. He would have minimized it.

Nor did Treiger's later conduct indicate any desire to capitalize on the dual relationship with Severance and Nutwood. Instead, the study was turned over to two key employees, John Marshall and Tom Darmstadter, who exercised their best professional judgments on Nutwood, unfettered by any knowledge that their employer might buy Severance, and unfettered by any intervention by any Smith employees who did have such knowledge (Marshall Tr., App. 90-92; Darmstadter Tr., App. 94-95). It is hard for us to discern how the overall handling of the Nutwood inquiry by Smith fits the bad faith definition of the Ohio Supreme Court requiring dishonest purpose or ulterior interest. In retrospect, against the knowledge that the Smith firm successfully financed an interest in Severance and that the Nutwood report turned out negative, it is perhaps unfortunate that the firm agreed to help Hilltop. But at the very worst, the nondisclosure constituted constructive fraud since the element of intent

to deceive, as defined in the Ohio decisions, is totally lacking.

C. Materiality, a Necessary Element of Actual Fraud, Is Lacking

The crucial test of materiality is, of course, whether Smith would have been employed if Treiger had said that in addition to its consulting responsibilities Smith was considering the acquisition of a proprietary interest in Severance. All the evidence on the point indicates that Smith would have gotten the job anyway.

O'Neill's flat statement that Smith's "loyalty to Austin and Severance might reasonably be expected to prevent Smith & Co. from making any recommendations . . but it was considered worthwhile to get Smith's survey and recommendations, having in mind that his work on the Longwood project had given him a great deal of background information . . .", raises a strong inference that O'Neill and Petti would have hired Smith if they had known of the Severance negotiations (A.F., App. 48). Moreover, Petti always insisted, and testified at trial, that Severance and Nutwood would cater to distinct trade areas. They were essentially non-competitive. Petti drew his own trade area for Nutwood, which did not touch the Severance site (Tr. 290-295, 320-322). Petti told the president of The May Company that Nutwood was a good spot for a May branch because Nutwood and The May Company's branch at Cedar Center did not conflict (A.F., App. 87-88, See Tr. 421-425). Yet, Cedar Center is virtually the

same distance southwest from Nutwood as Severance (See Plate 1). Petti told Treiger in their very first conversation that Smith's Severance connection did not bother him because he did not believe Nutwood would pull to the west anyway.

The test of materiality under Ohio law is stated in 24 *O. Jur.* 2d 695, 696, Fraud & Deceit § 99:

> "A fact is material when it influences a person to enter into a contract or when it deceives him and induces him to act, or when without it the transaction would not have occurred." See *Twachtman v. Connelly,* 106 F. 2d 501, 506 (6th Cir. 1939).

The undisputed facts that Hilltop hired Smith knowing of Smith's pre-existing commitment and loyalty to Severance and of Petti's unshakeable conviction that Nutwood and Severance did not conflict, because Nutwood would not pull to the west, simply do not support a finding that Hilltop would have hired another consulting firm if it had known of the pending Smith-Austin negotiations.

D. Reliance, a Necessary Element of Actual Fraud, Is Lacking

The court's basic finding on reliance was,

> "Hilltop relied on such belief [that Smith was no more than a consultant on Severance] in selecting Smith to produce a market analysis and all plaintiffs relied thereon in determining their course of conduct after the negative report was received" (M.D., App. 11-12).

The reliance which the court found to be an ingredient

of fraud is thus reliance on the nondisclosure and not reliance on the report. Even if we assume for argument that O'Neill and Petti relied upon Treiger's statements as to Smith's consulting relationship, and that they also had these statements in mind when they sold Nutwood, such reliance would be of no consequence unless they relied on the Smith report, *and* the Smith report was incorrect. Does one who relies in purchasing a business on true and correct statements by a broker that the business has certain income, inventory and accounts receivable have an action in damages against the broker if he learns later that the broker was considering the purchase of an interest in a competing business? In this case the court stated his belief in "the accuracy of the conclusions in the report" (R. 2089) and held that the "plaintiffs relied on the conclusions of the report and not on the details of the analysis in making their decision to sell the property to Ridge Hills (M.D., App. 10). In these circumstances, whether plaintiffs relied on the nondisclosure either in hiring Smith or selling Nutwood is immaterial. The court held there was no proof that Nutwood was worth a nickel more than Ridge Hills paid for it. Hilltop was paid $56,580.75 as its brokerage commission (R. 1238) and went to work for the new owners before the sale to them was even closed (Kammer Tr., App. 123). O'Neill was paid $27,828.00 for his services to the sisters, 5% of the total sales price (R. 1238). The sisters received $613,161 from Ridge Hills plus $245,000 from previous sales to others (R. 1056) or $858,161 for property which had

been appraised in 1952 at $190,510 (R. 1055). Smith received $2,920 for a valid and correct memorandum, for which it is now sued for $8,862,500 plus attorneys' fees (R. 113). The irony is that not only was the Smith report a sound one, but the evidence is clear, cogent and convincing that plaintiffs did not rely upon it. That evidence, which we will not repeat here, was summarized in our "Statement of the Case", *supra*, p. 19-25. It has a sort of ten-pin aspect. Mrs. Powell who was in the Virgin Islands relied on her sister Mrs. Ashcraft, who was in Madrid; Mrs. Ashcraft relied on O'Neill and O'Neill relied on Petti (Tr., App. 125, 128, 62-64, 65-69).

Boiled down, the issue is whether Petti relied. We have Petti's word under oath that he relied only on the optimistic parts of the Smith report and rejected the pessimistic parts (Tr., App. 114). This should need no confirmation. But there is an amplitude of supporting evidence. First, we have Petti's own letter to Peter Galvin, Ex. 348A, sent three weeks after receiving the Smith report, in which he boasted of Nutwood's unique qualities as a regional shopping center site. Second, we have the testimony of Karl Kammer, a member of the Cleveland bar, who had no interest in these proceedings, who testified that Petti told him and his clients, Harry Ratner and Fred Stark, on three or four occasions after receiving the Smith report, that "'This is a great location for a shopping center complex'" (Kammer Tr., App. 119-120). Petti said this not as a sales puff. He went right to work

for Ridge Hills to line up stores. He spent two and one-half years at this occupation, and gave up only in April, 1962 (Appendix, Part V). Since he couldn't interest anyone in Nutwood as a shopping center, he turned to litigation. His central theme in the litigation was that Nutwood had been sold to Ridge Hills as residential property after the Smith report (Tr. 378-384). In fact, he stated that Harry Ratner was purely a residential developer (Tr. 368-370). As residential property, he claimed it was worth $3,500 an acre. Actually Petti sold Nutwood as a regional shopping center. Ridge Hills purchased it for the purpose of developing such a center (Kammer Tr., App. 121-122). Petti never relied on the Smith report's negative conclusions for one minute. If he had, he would have saved himself two years of hard work. His vain attempts from January, 1960 until April, 1962 to develop Nutwood as a regional center provide the most eloquent refutation of his reliance.

E. Specific Damage or Financial Injury, a Necessary Element of Actual Fraud in Ohio, Is Lacking

In Ohio, as elsewhere, in a damage action for fraud:

> ". . . Plaintiff must allege and prove some specific damage sustained because of the deceit or fraudulent conduct" *Twachtman v. Connelly*, 106 F. 2d 501, 506 (6th Cir. 1939).

Also see *Miller v. Knight*, 115 Ohio App. 485, 185 N.E. 2d 770 (1961); 24 *O. Jur.* 2d 634, Fraud & Deceit § 20.

As to what constitutes damage, Ohio Jurisprudence

states:

> "Negatively framed, the rule as to what constitutes damages, in any case, may be stated broadly to be that there is no damage where the position of the complaining party is no worse than it would have been had the alleged fraud not been committed" 24 *O. Jur.* 740, Fraud & Deceit § 151.

First, as to the sisters, it could not possibly be said seriously that their position was worsened because of the Smith report. Their situation was improved. Their advisor, O'Neill, received a copy of a report which correctly concluded that their property was not suitable for a regional shopping center. They sold Nutwood to Ridge Hills for its full value. Nevertheless, the court awarded the sisters $2,920.

The judge's reasoning was that the sisters were somehow injured by being contaminated by their agent's contact with a report which held the possibility of non-objectivity because of Smith's negotiations on a property their agent testified to be wholly non-competitive with Nutwood. Even if this occurred, the event would not satisfy the requirement that the sisters show specific damage.

Second as to Hilltop, it paid Smith $2,920 for a report which it used extensively in its efforts to sell Nutwood for the sisters and for Ridge Hills.

It was only in *failing* to rely on the negative conclusions of the report that Hilltop worsened its position by working two years in vainly trying to make Nutwood a

regional shopping center. It received a report which its own expert at trial, Dr. John M. Rienstra, testified was made according to "acceptable methods", and which contained no substantial errors of fact, except for one concerning the floor area of a Sears store (Tr., App. 132). As to this alleged error, Petti spotted it and brought it to Treiger's attention as soon as he received the report (Tr. 337-47, Ex. 45). The court found, "Thus, Smith fully performed its contract, in spite of what later proved to be inconsequential errors in its report" (M.D., App. 17). The court made it clear that Hilltop got its full money's worth under its agreement with Smith.

From the foregoing one conclusion must be drawn. Plaintiffs did not prove that they were damaged either in the financial injury sense or in the broadest sense that their position was worsened by the Smith report.

II. The Court's Conclusion That Hilltop and the Sisters Are Entitled to Compensatory Damages In the Amount Paid By Hilltop For The Report Is Inconsistent with the Court's Findings (Specification of Error No. 2)

The court's findings as to damages were that plaintiffs incurred none in relying upon the report and in selling Nutwood (M.D., App. 10). The court's further conclusion that Hilltop did incur damages in the amount paid for the report (M.D., App. 12, 16, 25) collides not only with its evidentiary fiindings of no damage in selling Nutwood, but also with its finding that Smith fully performed its

contract with Hilltop (M.D., App. 17). Since the sisters claim to have relied fully upon the report, without any knowledge that it was "legally worthless" or "untrustworthy", and the court has found that they suffered no harm thereby, how is it that this "legally worthless" but factually valuable report produced damage to them? What the court seems to have done is to grant Hilltop and the sisters some species of rescission.

III. The Court's Award of the Price of the Report to Hilltop Amounts to Granting Relief of Rescission, Contrary to Hilltop's Election to Sue for Damages (Specification of Error No. 3)

The damages awarded amount to a decree of restitution or rescission. The court found, in effect, fraud in the inducement (M.D., App. 16). But the judgment is in error for several reasons. First, actual damage, not proven here, is a requirement even in rescission cases. *Block v. Block,* 165 Ohio St. 365, 135 N.E. 2d 857 (1956); *Miller v. Knight,* 115 Ohio App. 485, 185 N.E. 2d 770 (1961). Second, rescission was never pleaded and no issue of rescission was framed in the pretrial order. Third, notice of election to rescind was not given promptly after the facts claimed to warrant restitution became known. Fourth, damages and rescission based on fraud are inconsistent remedies. One must elect between them. Plaintiffs elected to sue defendants for damages when they filed this action. These rules apply in all jurisdictions, including Ohio. 25 *O. Jur.* 2d 7-8, Fraud & Deceit § § 172-73.

Finally, Petti put the possibility of rescission irrevocably behind him when he used the Smith report in his continued promotion of Nutwood (Tr. 507, 510). Hilltop's standard promotional pitch for Nutwood invariably contained, for years after he learned of Smith's interest in Severance, large verbatim passages from the favorable portions of the Smith report. (See e.g., Ex. 348A, dated January 25, 1960; Ex. 235, a brochure prepared for The May Company, June 29, 1960; Ex. 239, a brochure prepared for The Higbee Company, October 18, 1960; Ex. 211A, a brochure prepared in April, 1961).

It is still more difficult to understand the court's award to the sisters on an apparent rescission theory. The court expressly found that the sisters were not third party beneficiaries of the Smith-Hilltop contract (O.O., App. 3, 6-7). Rescission is not ordinary granted to strangers to an agreement. They have nothing to restore or to have restored. The court's apparent rationale of its award to the sisters was that Hilltop was obligated to provide the sisters with a market analysis. We do not understand how an award to the sisters can be supported by this finding. In any event, it is clearly contrary to the evidence.

IV. The Court's Finding That Hilltop Was Obligated to Provide a Market Report to the Sisters Is Contrary to the Agreement Between Plaintiffs (Specification of Error No. 4)

In view of the court's dismissal of the sisters' action for breach of contract, the court's finding that Hilltop had

a duty to furnish them with a report may be of no practical moment. However, if the award of $2,920 to the sisters is rationalized on some contractual theory, which seems to be what the lower court was saying in its initial memorandum (M.D., App. 17), then such finding has practical effect.

The court's finding is contrary to the agreement itself. It will be seen from the partial text of the agreement reprinted at pages 41-42 of the appendix hereto that Hilltop did not agree to procure a market analysis as a condition of its exclusive. Rather, it was agreed that its exclusive would be extended beyond December 31, 1959 if two of five stated objectives had been accomplished before that date, and that Hilltop's failure to accomplish two of the objectives should not preclude an extension (Ex. 197A, p. 4). Moreover, under Ohio law, one who furnishes a professional report is liable only to the person employing him. *Thomas v. Guarantee Title & Trust Co.*, 81 Ohio St. 432, 91 N.E. 183 (1910).

V. The Award of Punitive Damages and Attorneys' Fees Is Contrary to Law and Contrary to the Facts Found by the Trial Judge (Specification of Error No. 5)

A. A Washington Judge Sitting in this Diversity Case Would Refuse to Apply Ohio Law on Punitive Damages and Attorneys' Fees Which Conflicts with the Long Established Public Policy of Washington

1. General Considerations:

A District Court in a diversity case will look to the

law of the forum state regarding matters of substantive law. *Erie R. Co. v. Tompkins,* 304 U.S. 64 (1938). Conflict of laws rules are substantive, so the court will follow the conflict rules of the forum state. *Klaxon Co. v. Stentor Elec. Mfg. Co.,* 313 U.S. 487 (1941). Therefore it is the law of Washington which controls the choice of law regarding the possibility of recovery of punitive damages.

2. Washington Law:

Washington rejects the doctrine of punitive damages as a matter of public policy. In an unbroken line of cases from *Spokane Truck and Dray Co. v. Hoefer,* 2 Wash. 45, 25 Pac. 1072 (1891) to *Conrad v. Lakewood Gen. Hosp.,* 67 Wn. Dec.2d 925, 410 P.2d 785 (1966), the court has held that punitive damages cannot be awarded in Washington. The classic statement of the rule is found in the *Spokane Truck* case, 2 Wash. at 53-54:

> ". . . Surely the public can have no interest in exacting the pound of flesh. . . . It is to be presumed that the state has fully protected its own interests, or as fully at least as they could be protected by laws, when it provides for the punishment of crime in its criminal statutes, and fixes the fine at a sum which it deems commensurate with the crime designated; hence, punitive damages cannot be allowed on the theory that it is for the benefit of society at large, but must logically be allowed on the theory that they are for the sole benefit of the plaintiff, who has already been fully compensated; a theory which is repugnant to every sense of justice."

The court summarized its position by stating,

> ". . . we believe the doctrine of punitive damages is unsound in principle and unfair and dangerous in practice. . . ." 2 Wash. at 56.

The Washington court frequently has referred to punitive damages as punishment. A recent restatement of the view taken in *Spokane Truck* that punishment is the prerogative of the state and has no place in a civil action is found in *Browning v. Slenderella Systems*, 54 Wn.2d 440, 341 P.2d 859 (1959).

The Washington Supreme Court has not been called upon to pass on the enforceability of foreign punitive damage laws. It has, however, on several occasions refused to enforce other foreign laws on the ground of public policy, about which its expressions are mild indeed, compared to its strong views on punitive damages. Leading cases are *Carstens Packing Co. v. Southern Pac. Co.*, 58 Wash. 239, 108 Pac. 613 (1910) (rejecting California law limiting liability of a common carrier) and *Farley v. Fair*, 144 Wash. 101, 256 Pac. 1031 (1927) (rejecting Oregon law as to statute of frauds).

3. Conflict of Laws Rules:

Washington, in dealing with conflict of laws questions, follows closely the approach taken by standard authorities such as the Restatement, Conflict of Laws and Beale's text. See *Richardson v. Pacific Power & L. Co.*, 11 Wn.2d 288, 118 P.2d 985 (1941). As to the enforcement of foreign punitive damage laws those authorities state:

Restatement, Conflict of Laws (1934):

"Section 421. EXEMPLARY DAMAGES.

"The right to exemplary damages is determined by the law of the place of wrong.

"Comment:

"a. *When damages regarded as penal.* In those states where exemplary damages are never allowed, such damages may be refused in an action on a foreign wrong, whatever the law of the place of wrong, on the ground that they are penal (See Section 611) . . .

* * *

"Section 611. ACTION FOR A PENALTY.

"No action can be maintained to recover a penalty the right to which is given by the law of another state.

"Comment:

"a. A penalty as the word is used in this Section is a sum of money exacted as punishment for a civil wrong as distinguished from compensation for the loss suffered by the injured party. . . .

"b. Examples of a penalty which cannot be recovered in another state are: . . .

"3. penal or exemplary damages awarded in addition to full compensation, when action is brought in a state which does not award such damages on the ground that to do so would be to impose a penalty.

* * *

"Section 612. ACTION CONTRARY TO PUBLIC POLICY.

"No action can be maintained upon a cause of action created in another state the enforcement of which is contrary to the strong public policy of the forum."

2 Beale, Conflict of Laws § 421.1 (1935):

> "Exemplary damages are not regarded as penal in most states. If such damages are allowed at the place where the wrong was done, they are recoverable in any state which allows such damages. In a state, however, where exemplary damages are not allowed, *such damages cannot be included, whatever the law of the place of injury, for they would be regarded as penal.*" (Emphasis added).

The Washington policy is a perfect example of the applicability of Restatement § 421, Comment a, and the last sentence of 2 Beale § 421.1. Indeed, if these sections did not apply to the Washington situation, they would have virtually no meaning since there are only three states in addition to Washington which refuse to award punitive damages. 25 *C.J.S.* 1112-13, Damages § 117(1).

4. Ohio Law:

The Ohio law of punitive damages will be discussed more fully in succeeding sections of this brief. For present purposes, it is sufficient to note two features. First, just as Washington does, Ohio regards punitive damages as punishment and as a penalty. *Saberton v. Greenwald,* 146 Ohio St. 414, 66 N.E.2d 224, 229 (1946), wherein the court quoted from *Atlantic & Great W. Ry. Co. v. Dunn,* 19 Ohio St. 162, 2 Am. Rep. 382. Hence, the type of damages which a Washington judge would be asked to award here is the very type which Washington emphatically rejects as contrary to public policy.

The second point of significance is that the doctrine has been seriously criticized in Ohio. *Saberton v. Green-*

wald, 146 Ohio St. 414, 66 N.E.2d 224, 229 (1946), the point of departure for all recent Ohio decisions on the subject, was decided four to three. The dissenting opinion attacked not only the extension of the doctrine of punitive damages to the case before it, but the entire concept.

The dissent cited, *inter alia, Spokane Truck & Dray Co. v. Hoefer,* 2 Wash. 45, 25 Pac. 1072 (1891).

In view of the unusually strong public policy enunciated by the Washington Supreme Court at every opportunity against punitive damages, in view of Washington's adherence to the Restatement and Beale, and the position taken by those authorities, and in view of the fact that the doctrine survives in Ohio by the slender thread of a single vote, it seems plain that Washington would refuse to apply the Ohio law of punitive damages.

B. The Court's Finding That Appellants Are Liable for Punitive Damages is Inconsistent with the Court's Evidentiary Findings.

In its tentative opinions delivered immediately after hearing the evidence the court expressed the fixed opinion that Smith's nondisclosure amounted to constructive fraud (O.O., App. 2). After learning through post-trial briefs that constructive fraud would not support the assessment of punitive damages, the court found the same nondisclosure to constitute actual fraud because it showed "a wanton or reckless disregard for the rights of others . . ." (M.D., App. 12). After being fur-

nished with further briefs which indicated that if "wanton or reckless disregard" was ever a sufficient predicate in Ohio for punitive damages, that day was long past, the court announced that the same nondisclosure constituted "extreme and exceptional conduct" constituting a "gross fraud" (M.D., App. 22). In Section VIII of this brief, we point out that even this finding is insufficient, in the absence of a further finding of "actual malice." Here, we merely refer the court to several Ohio cases which, together, demonstrate the type of conduct required for imposition of punitive damages in Ohio. We shall not extend this brief by repeated detailed reference to the trial court's evidentiary findings. We do ask this court to compare the criteria for punitive damages in Ohio with admitted facts and findings that Smith's employees were not actuated by desire for gain (O.O., App. 8-9, 15), that Treiger told plaintiffs of Smith's continuing consulting relationship to Severance and its previous loyalty and commitment to that project (A.F., App. 48), that Petti assured Treiger that Severance and Nutwood were totally non-competitive (A.F., App. 44-45, Tr. 291), that the Nutwood study was carried out by personnel who did not know of Smith's possible potential interest in Severance (Tr., App. 88-95) and that the report, after three years of unremitting attack upon it, was found by the court to be accurate (R. 2089). Again, we say that the nondisclosure, when viewed at the worst, was an honest mistake in judgment. It was, after all,

Smith's connection with Severance which plaintiffs felt they could capitalize on, which caused them to employ Smith (A.F., App. 48, see App. 40-41). The conduct of Smith's employees, as revealed by the undisputed record, simply does not fit the "very corrupt condition of affairs" (*Cable v. Bowlus,* 11 Ohio Cir. Dec. 526 (1904)) required to move the court to punish the defendants in a civil action.

In *Saberton v. Greenwald,* 146 Ohio St. 414, 66 N.E. 2d 224, 230 (1946), the court quoted from 13 *O. Jur.* 238, in reviewing the general policy on punitive damages,

> "'. . . the principle of permitting damages beyond naked compensation is for example, and the punishment of the guilty party for the wicked, corrupt, and malignant motive and design which prompted him to the wrongful act.'"

VI. An Award of Nominal Damages Will Not Support An Award of Punitive Damages (Specification of Error No. 6)

We do not believe that any tort was committed, and, therefore, do not believe that plaintiffs should have been awarded any damages, even nominal. But even if this court should hold that there was a tort, there were no actual damages. At most, nominal damages would be proper, for a technical invasion of plaintiffs' rights.

The Supreme Court of Ohio in *Richard v. Hunter,* 151 Ohio St. 185, 85 N.E.2d 109 (1949), in adopting a quotation from *Am. Jur.,* pointed out the distinction between nominal damages awarded for a bare violation of legal

rights which produced no damage, and actual damages, so small in amount as to be loosely described as "nominal." The fact that the court considered the terms "nominal" and "actual" to be mutually exclusive is shown by the court's statement that

> "[T]he record clearly shows that there were no damages, either actual or nominal." 85 N.E.2d at 111.

Therefore when the court in *Richard* held in its syllabus that

> "Exemplary or punitive damages may not be awarded in the absence of proof of actual damages"

it clearly held that punitive damages may not be added to nominal damages. Accord, *Cahill v. Fidelity & Cas. Co.*, 37 Ohio App. 444, 175 N.E. 39 (1930) and *Levin v. Elyria Sign Co.*, 1 Ohio App.2d 512, 206 N.E.2d 38 (1965).

VII. Since the Court Found that Defendants Were Not Guilty of Actual Malice, Punitive Damages and Attorneys' Fees cannot be Awarded (Specification of Error No. 7)

The starting point in discussing punitive damages has been *Saberton v. Greenwald*, 146 Ohio St. 414, 66 N.E.2d 224 (1946), although more often than not, reference has been made to the *dissent* for a correct statement of Ohio law. The frequently quoted passage from the *Saberton* dissent is as follows:

> "This court has, over the years, recognized the propriety of submitting to a jury the question of the

> assessment of punitive damages in certain tort cases where the defendant's wrongdoing has been intentional and deliberate, or has the character of outrage frequently associated with crime. Not all tort actions are of such a character as to warrant the assessment of punitive damages. *Generally the application of the doctrine is confined to cases where there is involved actual malice, interference with marital relations, or wanton personal injury,* such as in cases of seduction, assault and battery, false imprisonment, or wrongful expulsion from public passenger vehicles or places of public entertainment." (66 N.E. 2d at 334; emphasis added)

Even though found in a dissenting opinion, this summary is the law of Ohio. In adopting this statement of the rule, the Supreme Court in *Smithhisler v. Dutter,* 157 Ohio St. 454, 105 N.E.2d 868, 872 (1952), noted that even in *Saberton* "there was no division upon this statement."

According to this rule, punitive damages are limited to cases involving (1) actual malice (2) interference with marital relations and (3) wanton personal injury. Only the first could apply to the present litigation. The necessary inference that in a fraud case actual malice is a prerequisite to punitive damages was made an explicit rule in *Waters v. Novak,* 94 Ohio App. 347, 115 N.E. 2d 420 (1953).

In *Sears v. Holly,* 113 Ohio App. 349, 178 N.E. 2d 91 (1960), the *Waters* holding was repeated. Again quoting from the dissent in *Saberton,* the court followed *Waters* and held an instruction prejudicially erroneous which stated that implied malice was sufficient to award punitive

damages in a fraud action. A recent federal case in Ohio also held actual malice to be the *sine qua non* of a recovery of punitive damages in an action for misrepresentation. *Nagel v. Prescott & Co.,* 36 F.R.D. 445 (N.D. Ohio 1964).

Moreover, in two recent opinions the Ohio Supreme Court has reaffirmed that actual malice is a prerequisite to an award of punitive damages. *Davis v. Tunison,* 168 Ohio St. 471, 155 N.E. 2d 904 (1959); *Pickle v. Swinehart,* 170 Ohio St. 441, 166 N.E. 2d 227 (1960). In *Pickle,* the court stated that actual malice and ill will are the same (166 N.E. 2d 229).

The argument that *Saberton* justifies awarding punitive damages for "wanton disregard" cannot be reconciled with the Ohio Supreme Court's later opinion in *Rogers v. Barbera,* 170 Ohio St. 241, 164 N.E. 2d 162 (1960).

In *Rogers,* a malicious prosecution case, the court went so far as to correct the syllabus in *Davis v. Tunison,* 168 Ohio St. 471, 155 N.E. 2d 904 (1959), to remove a suggestion contained therein that actual malice could be inferred from "prosecution of one wantonly, recklessly and without justification".

Rogers is the most recent holding by the Supreme Court of Ohio on the subject. It is quite explicit. We note further that the Ohio Supreme Court in 1933 declared that attorneys' fees, which are awarded only when punitive damages are assessed, are not assessable unless there

is proof of actual malice. *New York, Chicago & St. L. R. Co. v. Grodek,* 127 Ohio St. 22, 186 N.E. 733 (1933); also see *Fremont Oil Co. v. Marathon Oil Co.,* 192 N.E. 2d 123, 130 (Ohio Com. Pl. 1963).

VIII. Punitive Damages Must Bear a Reasonable Relationship to Compensatory Damages. (Specification of Error No. 8)

For many reasons already discussed herein, any award of punitive damages against appellants would be erroneous. But assuming for argument that such an award is proper, the amount set by the district judge was excessive, since it is not in a reasonable ratio to compensatory damages, as required by Ohio law. The Supreme Court of Ohio in *Richard v. Hunter,* 151 Ohio St. 185, 85 N.E. 2d 109, 112 (1949) quoted from a leading West Virginia case:

> "'Moreover, *where there is a legal finding of compensatory damages, punitive damages, if awarded, must bear a reasonable proportion to the compensatory damages so found.*'"

The Ohio court then stated:

> "In accordance with the majority rule, as shown by *the above cited authorities which have our complete approval,* the verdict returned by the jury in the instant case was defective and did not authorize a judgment in favor of the plaintiff". (Emphasis added).

In the present case neither the punitive damages nor the attorneys' fees awarded bear any reasonable relation-

ship to the actual damages. Actual damages, assuming for argument that they really are such, total $5,840.00. Any punitive damages awarded must, therefore, be limited to a low multiple of $5,840.00, far less than the $75,000.00 awarded. Attorneys' fees awarded as an incident of punitive damages must, moreover, be in reasonable proportion to the actual damages awarded. Otherwise, the "ratio" rule would be rendered meaningless.

IX. Plaintiffs Knew All Essential Facts of the Smith-Austin Relationship Years Before They Commenced This Action (Specification of Error No. 9)

The following finding and conclusion by the court are erroneous:

> ". . . Smith . . . deliberately withheld information, the disclosure of which in all probability would have rendered this expensive lawsuit unnecessary. In the court's view these facts amply justify an award of punitive damages in an amount sufficient to compensate plaintiffs for the expenses of this lawsuit . . ." (M.D., App. 17; see also M.D., App. 14).

In so finding, the court was not referring to the original nondisclosure when the Smith firm was retained. This is clear from colloquy between the court and counsel during an argument on April 22, 1966. From its remarks there it is clear that the court incorrectly felt that Hilltop had to bring suit to discover the basic facts of the Smith-Austin negotiations (R. 2123-25, 2132-34). This is entirely contrary to the direct testimony of plaintiffs' own witness,

Wilbert J. O'Neill:

1. On August 12, 1960, within two weeks after the newspaper release announcing Smith's interest in Nutwood, and before O'Neill and Petti met with Treiger, Petti told O'Neill that he had already "complained bitterly" to Treiger about the fact "that when they accepted this employment they were already negotiating to buy" Severance (O'Neill Tr., App. 129). Petti repeated his complaint to Treiger at the meeting (O'Neill Tr., App. 130-131).

2. Herbert Spring, Smith's lawyer in Cleveland, told O'Neill and Petti on February 15, 1961 that the Smith-Austin deal was closed on February 10, 1960, and that the negotiations had been going on since March, 1959, six months before the initial Hilltop-Smith contact.

Counsel for Hilltop at the argument on April 22, 1966, when confronted with O'Neill's testimony, quickly shifted to a position that the real trouble was that Smith had suppressed the workpapers from which the memorandum was written (R. 2123-25). Counsel for Smith reminded the court that the workpapers had never been requested before suit was commenced and the court said, "That may very well be" (R. 2132). The fact is that it was the court who had asked the secretary of Hilltop whether they had ever sought Smith's workpapers and received the reply, "No, sir" (Crume Tr., App. 131).

The court's final reason for feeling that plaintiffs were

justified in bringing suit, and should, therefore, be awarded $150,000 for litigation costs was a recollection, without looking at its notes that, "there were quite a few letters asking for information that they never got a response to" (R. 2134).

What letters? Petti first wrote to Treiger on August 2, 1960 (A.F., App. 80). Treiger went to Cleveland on August 10 or 12 and had dinner with Petti and O'Neill to explain Smith's position. He left them copies of a memo explaining that position (A.F., App. 80-85). Petti and O'Neill were, of course, at liberty to disagree with that position. But the discussion centered on whether Smith was right or wrong, not on whether Petti and O'Neill had the facts. Petti already knew before the meeting that the Severance negotiations had preceded Hilltop's retention of Smith.

Next came a letter from Hilltop to Treiger on September 17, 1960, followed up by a letter from Hilltop's attorney on October 20, 1960 (A.F., App. 85-87).

In response to these letters, the Smith firm assigned a top employee who had not worked on the original analysis to review the Nutwood study to make certain that it was basically correct. Shortly after the review memorandum (Ex. 10) was prepared, Petti, O'Neill and Petti's lawyer were invited to the meeting in Spring's office, where they were given copies of the review.

As time passed after February 15, 1961, Smith could

feel that the Nutwood affair was closed. But some time after Petti finally exhausted his efforts to promote Nutwood in April, 1962, he decided to litigate. Strangely, Petti decided to sue only after his fruitless promotion of Nutwood had provided the ultimate vindication of Smith's conclusions.

The court stated that Smith "deliberately withheld information, *the disclosure of which in all probability would have rendered this expensive lawsuit unnecessary*" (M.D., App. 17, emphasis added). The court's finding seems illogical in view of the cross appeal filed by plaintiffs in this court. Almost four years after action was commenced, after several thousand pages of pleadings, several thousand more pages of depositions and several thousand more pages of testimony at trial and hundreds of exhibits produced by Smith, this expensive lawsuit is still necessary to plaintiffs.

Even were one to assume, contrary to the evidence out of the mouths of plaintiffs' own witnesses on direct examination, that the Smith firm failed to cooperate in Hilltop's investigation of Smith's conduct after the public announcement, the question remains whether this fact justifies the imposition of litigation costs against the present appellants in the form of punitive damages.

X. In Deciding Whether to Impose Punitive Damages and Attorneys' Fees, the Court Used an Incorrect Criterion, Namely, Whether Plaintiffs Were Justified in Bringing Suit. (Specification of Error No. 10)

The court's view that the lawsuit was "caused" or could have been avoided by some disclosure by Smith is mistaken. When plaintiffs completed discovery in this case, they did not move for voluntary nonsuit and say, "If we had only known, we would never have commenced suit. Why didn't you tell us?" Rather, they increased their prayer by $7,000,000 and prepared to go to trial. Indeed, if Hilltop had asked for return of its $2,920 Smith easily might have complied to avoid a lawsuit. Defendants were not only never offered this alternative, but, according to Treiger's memo of his August, 1960 meeting, Petti and O'Neill did "not question the fact that they owed us the money and would have paid us in any event" (A.F., App. 85).

If plaintiffs' complaint had simply sought return of the $2,920 to it as now ordered by the court, defendants would have been afforded an opportunity to settle the matter at the threshhold. Instead, defendants were faced with baseless monopoly claims for millions upon millions of dollars. To hold that defendants must pay $150,000 to plaintiffs for litigation expense is to penalize defendants for defending themselves against claims which the court has found to be without merit. And yet, that is the effect of the court's action. It expressly held that defendants must pay plaintiffs' attorneys' fees and litigation expenses attributable to the specious state and federal antitrust claims (M.D., App. 17). Nowhere in the record is there the slightest suggestion that plaintiffs asked de-

fendants any question bearing on antitrust before filing their complaint.

In sum, judgment for "actual" damages in an amount which is considerably less than the amount necessary to claim jurisdiction in a diversity case was awarded on one of four causes of action against the original three Smith partners and their wives, and, to the extent of their interest in the firm assets, against two more partners and their wives, out of twenty-six defendants named in the caption. The court's theory of punishing these defendants was not, according to its decisions, for the conduct of their employees in failing to disclose the Severance negotiations but was apparently based on the judge's idea that Treiger did not answer Petti's letters promptly enough.

XI. The Court's Finding That the Partners Were Aware of Treiger's Conduct is Contrary to the Undisputed Evidence. (Specification of Error No. 11)

The district court attempted in two ways to tie the partners in to the acts of Treiger. It first found that:

> ". . . The company's method of doing business, of keeping the partners in its far-flung organization informed, and its system of reading files make the inference inescapable that one or more of the partners was aware of the concealment and at least acquiesced therein" (M.D., App. 13).

It should be noted that part of the finding, that the Smith organization was "far-flung," militates against the ultimate finding that the partners knew about Treiger's

contacts with Hilltop. It is not at all clear what the court meant by "The company's method of doing business, of keeping the partners . . . informed." The only evidence of any method which the company had of keeping partners informed concerns the "reading files," to which the court made specific reference. Therefore, this finding comes down to an inference, based on the existence of the reading files, that some unidentified partner knew of and acquiesced in Treiger's concealment.

The reading file was a manila folder containing copies of letters and memoranda concerning the many jobs which Smith might be working on at any one time (Imus Tr. 737). Even if the partners routinely read such bulky and heterogeneous files, the inference would hardly be "inescapable" that some one of them had read the Hilltop materials. When one considers the fact that the partners rarely read these files, the inference becomes even more speculative. Even if a partner had read the file, he would have learned that, according to Petti, there was no conflict between Nutwood and Severance.

Orrico, whose professional activities were, by 1959, directed toward management of Winmar Realty Development Co., had virtually no direct contact with the consulting work of Larry Smith & Co. He merely attended partnership meetings, which were almost always held outside the offices of Larry Smith & Co.; he rarely visited the Smith offices, where the reading file was kept, and had not referred to the reading file "in the last few years"

(Tr., App. 137-41).

Arpke was also concentrating on activity with Winmar and no longer active in consulting work by 1959 (Tr., App. 144). Arpke testified that he worked in the Winmar offices, not the Larry Smith & Co. offices. His only contact with the consulting business was to attend partnership meetings (Tr., App. 144).

Larry Smith testified that his work kept him moving around the country, so that he maintained a home in Seattle and apartments in New York and Washington, D. C. (Tr. 2449-50). The Nutwood report had been prepared in the Washington, D. C. offices of Larry Smith & Co., but Smith stated that in his own Washington office, which was separate from the Eastern Division, he was not provided with correspondence or copies of reports, and that such materials were kept in the Eastern Division office (Tr. 2451-52).

It is obvious that any inference that the parties learned of Nutwood via the reading files is purely speculative. As Imus testified, the reading files were maintained for the "staff", not the partners (Tr. 737). Moreover, each of the three partners sought to be charged directly denied any notice of the existence of the Nutwood study through the reading files.

Orrico, the first of the partners to testify, was cross examined at length about the reading file, and denied having seen any of the material on Nutwood (Tr., App.

141-42). Cross examination of Arpke and Smith was more cursory, but equally destructive of any finding that the partners saw the Nutwood correspondence. Each denied having ever seen Exhibit 58-A, one of Hilltop's letters taken from the Seattle reading file (L. Smith Tr., App. 135-36, Arpke Tr., App. 145-46).

Thus, the finding that the partners knew of Treiger's activities is erroneous, as, of course, is the finding that they acquiesced therein. It is based neither on any evidence nor any reasonable inference from any evidence.

The court also found that:

> ". . . Treiger's attempts to justify and minimize the concealment at the meeting with Petti and O'Neill on August 10, 1960, in response to a written inquiry from Petti must have come to the attention of, or may even have been authorized by, one or more of the partners . . ." (M.D., App. 13).

Exhibit 58-A, about which each of the partners was cross examined, is a copy of a letter from Hilltop's general counsel to Larry Smith & Co., attention Ray Treiger, dated October 20, 1960. This letter followed by two months, and was in part concerned with, the meeting of August 10, 1960. If the partners had been aware of that meeting, they certainly would have read the correspondence which followed it, including Exhibit 58-A.

The court's finding that the partners were aware of Treiger's negotiations with Hilltop is contrary to the unchallenged testimony of those partners. In order to find knowledge and acquiescence, the court had to arbitrarily

reject uncontroverted evidence, which is clear error. *Joseph v. Donover Co.* 261 F.2d 812 (9th Cir. 1958); *Ariasi v. Orient Ins. Co.,* 50 F.2d 548 (9th Cir 1931).

XII. Since the Partners Did Not Authorize, Ratify or Participate in Treiger's Actions, an Award of Punitive Damages Against Them is Improper. (Specification of Error No. 12)

Virtually the entire judgment in this action consists of an award of punitive damages and attorneys' fees in favor of plaintiffs against five partners of Larry Smith & Co. While Ohio law recognizes vicarious liability for compensatory damages, personal involvement in or ratification of the tort by the person sought to be charged is essential to justify punitive damages. The judgment below is against five partners and their wives who had nothing whatever to do with the Nutwood report or the dealings with Hilltop. The judgment runs not against a partnership, but against individuals. In order for the punitive damage and attorney fee awards to stand, personal involvement of the individuals must be shown. The record is devoid of any such evidence.

The evidence of non-involvement may be briefly stated. Larry Smith first heard of Nutwood and Hilltop in late 1961 or 1962 (Tr., App. 133-35). Frank Orrico heard of them through Herb Spring sometime after the fall of 1960 (Tr., App. 138-39). Fred Arpke only learned of their existence when litigation had commenced or was threatened (Tr., App. 145).

York and McConnachie are judgment defendants only because they happen now to be partners in Larry Smith & Company. Neither was deposed. Neither was called to testify. The name of neither entered the testimony as having had any connection with the Nutwood study. Both filed affidavits in support of pretrial motions in which they swore that they never heard of Nutwood or Hilltop until after they were admitted to the partnership on August 1, 1960 (R. 19, 20).

When these facts are measured against the Ohio law regarding assessment of punitive damages against a principal for an agent's tort, it is apparent that the court erred in awarding such damages against appellants.

The general statement of the rule may be taken from *Tracy v. Athens & Pomeroy C. & L. Co.*, 115 Ohio St. 298, 152 N.E. 641, 642 (1926):

> "*Exemplary or punitive damages* being awarded, not by way of compensation to the sufferer, but by way of punishment to the offender, and as a warning to others, *can only be awarded against one who has participated in the offense* . . .
>
> ". . . *The employer cannot be punished for the personal guilt of his servant or agent, unless the employer authorized, ratified, or participated in the wrongdoing.*" (Emphasis added)

In the *Tracy* case, the Supreme Court held that an instruction which imputed the misconduct of a mine superintendent to his employer was prejudicially erroneous since this instruction, coupled with the instruction

given on damages, allowed punitive damages to be assessed against the corporation without any showing of authorization, ratification or participation by the corporation.

A similar statement of the rule may be found in *Stockyards Bank v. Seal,* 27 Ohio App. 179, 161 N.E. 35, 36-37 (1927). In the *Stockyards Bank* case, the court held that the malice of the president of the defendant bank could not be imputed to the bank in the absence of ratification of the president's wrongful conduct. These two cases are noteworthy not only for their statement of the basic Ohio rule, but also for the fact that they involve conduct by an employee in a managerial position. Despite the wide authority that the agents possessed, the courts found that specific authorization, ratification or participation in the offense by the corporations was necessary to charge them with punitive damages.

There is good reason for imposing such a test on the award of punitive damages against a principal. Vicarious liability of any kind is harsh law, as is a doctrine of punitive damages. When the two may be combined, clearly great injustice may result unless the law requires that the principal have been closely involved in the alleged tort. In *Columbus Ry. P & L Co. v. Harrison,* 109 Ohio St. 526, 143 N.E. 32, 33 (1924), the court expressed this idea by quoting with approval from 2 Mechem on Agency, 2d Ed., Sec. 2014, as follows:

> "If they [punitive damages] are to be awarded at all, it would seem that, however much they may be justified against the guilty servant or agent himself, they should not be awarded against the principal or master unless it can be shown that in some way he also has been guilty of the wrongful motives upon which such damages are based. It seems hard enough against an innocent principal or master that he should be compelled to pay compensatory damages for the wrongful act of his servant or agent, without adding thereto punishment for that of which he is in fact actually innocent and the cases which are believed to be the best considered have adopted this view."

In the present case, the partners knew nothing of Nutwood, so they certainly were innocent of any "wrongful motives".

The trial judge recognized the obvious problems in finding authorization by persons who knew nothing about the transaction in question. In his oral remarks at the close of trial he observed:

> "I do not recall any evidence that any partner authorized the concealment or the misrepresentation with respect to Smith's true interest in Severance . . ." (O.O., App. 6).

In the first memorandum decision, where the findings on punitive damages are expressed, the court still did not find authorization *by the partners*. Instead, it found that fellow employees, Imus and Orndahl, authorized Treiger's conduct.

Imus' and Orndahl's authorization of Treiger's acts does not satisfy the Ohio test, which is that the *principal*

must authorize. Imus and Orndahl were not partners in 1959 and are not parties to the judgment. None of the appellants authorized Treiger to take the Nutwood job or to conceal information from Hilltop.

In his oral remarks at the close of trial, the judge stated:

> "I am confident that there is evidence from which the court could find that the acts and omissions of Treiger were ratified by one or more of the partners, and I ask plaintiffs' counsel to call such evidence to the court's attention in the briefs to be presented." (O.O., App. 6)

The judge apparently did not recall any specific evidence, and with good reason, since there is none. In the memorandum decision, written after plaintiffs had filed lengthy briefs, the judge was still unable to point to a single item of evidence indicating ratification.

CONCLUSION

The trial court's conclusions are not supported by its findings on evidence. The conclusion that employees of Smith were guilty of actual fraud is undermined by findings that they had no dishonest motive, no malice and no desire for pecuniary gain, and that plaintiffs, in any event, were not damaged by the alleged misconduct. The court took a case which, on its findings on evidence, might have supported conclusions of constructive fraud and nominal damages and, because of some mistaken but inflexible belief that the lawsuit was "caused" by